GAMING THE TAX CODE: PUBLIC SUBSIDIES, PRIVATE PROFITS, AND BIG LEAGUE SPORTS IN NEW YORK

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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GAMING THE TAX CODE: PUBLIC SUBSIDIES, PRIVATE PROFITS, AND BIG LEAGUE SPORTS IN NEW YORK

THURSDAY, SEPTEMBER 18, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m. in room 2154, Rayburn House Office Building, Hon. Dennis J. Kucinich (chairman of the subcommittee) presiding.

Present: Representatives Kucinich, Cummings, Tierney, and Watson.

Also present: Representative Weiner.

Staff present: Jaron R. Bourke, staff director; Charles Honig and Noura Erakat, counsels; Jean Gosa, clerk; Charisma Williams, staff assistant; Leneal Scott, information systems manager; Larry Brady, minority senior investigator and policy advisor; Adam Fromm, minority professional staff member; and William O'Neill, minority senior professional staff member.

Mr. KUCINICH. The committee will come to order.

We have a number of things going on on the Hill today. Members will be coming in and out, but we are going to start the hearing, in deference to our witnesses.

The Domestic Policy Subcommittee of the Committee on Oversight and Government Reform will now come to order.

We have been joined by the Honorable Congresswoman Diane Watson from California. Thank you, Ms. Watson.

Now, without objection, the Chair and the ranking minority member will have 5 minutes to make opening statements, followed by opening statements not to exceed 3 minutes by any other Member who seeks recognition.

Without objection, Members and witnesses may have 5 legislative days to submit a written statement or extraneous materials for the record.

Without objection, at some point we will be joined on the dias by Representative Anthony Weiner, who has asked to participate in today's subcommittee hearing.

The subject of our hearing today is: "Gaming the Tax Code: Public Subsidies, Private Profits, and Big League Sports in New York."

I am Congressman Dennis Kucinich, the chairman of the Domestic Policy Subcommittee. This is our third hearing in the last year and a half on the Federal Government's subsidization of the con-

struction of professional sports stadiums through the Federal Tax Code.

In our previous hearings we showed that building sports stadiums does not make sense as a tool of taxpayer subsidized economic development. From a State and local perspective, sports stadiums do not create jobs and, in fact, they use resources that would be better expended elsewhere, such as on building schools and shoring up crumbling infrastructure.

Rather, State and local governments compete with each other to lure or retain professional sports teams in a senseless race to the bottom for larger public subsidies subsidized by the Federal taxpayer.

As a result, not only are other more important public safety projects ignored, such as repairing structurally deficient bridges and aging water distribution and treatment systems, but granting a Federal tax exemption to bonds issued to build these stadiums means more stadiums and more expensive stadiums are being built than if there were no Federal subsidy.

Furthermore, stadiums are essentially private. Sports teams are privately owned by extremely wealthy individuals. The practice of providing taxpayer subsidies to the building of sports stadiums is a transfer of wealth from the many to the wealthy. This committee is charged with exposing waste, fraud, and abuse. In the case of the new Yankee Stadium, not only have we found waste and abuse of public dollars subsidizing a project that is for the exclusive benefit of a private entity, the Yankees, but also we have discovered serious questions about the accuracy of certain representations made by the city of New York to the Federal Government.

This subcommittee's still ongoing investigation has uncovered substantial evidence of improprieties and possible fraud by the financial architects of the new Yankee Stadium. The stadium project has already benefited from the issuance of over $900 million of tax-exempt bonds. The tax exemption on these bonds will save the Yankees well over $100 million in interest cost, a subsidy that will cost Federal taxpayers almost $200 million in lost tax revenues.

The city is now requesting that the IRS approve over $360 million in additional bonds to allow the Yankees to complete this stadium. These additional bonds would make it the most costly publicly funded stadium in the United States and would make it even more exorbitant, all on the taxpayers' dime.

At a minimum our investigation has shown that these bonds should not be approved without further investigation. Two wildly divergent valuations for the land under the stadium were submitted by the city and State government officials to the Federal Government.

In July 2006 the New York City Department of Parks and Recreation submitted to the National Park Service an appraisal for $21 million. That is for a 10.7-acre portion of the McComb's Dam Park. That is D-A-M. This parcel constitutes the majority of the New Yankee Stadium site. State and Federal law require that the city replace the park, which was destroyed to build the stadium, with one of at least equivalent value. The park appraisal arrived at the $21 million figure based on a rate of $45 per square foot.

While land appraisals are complex, the subcommittee has consulted with experts and has reached a provisional judgment that the park appraisal is, if not completely accurate, reasonably based on the comparable properties used to calculate value. At the same time, New York City Industrial Development Agency submitted to the Internal Revenue Service a $204 million assessment of the stadium site that was conducted by the city's Department of Finance for largely the same land. This figure appears to be wildly inflated. The assessment is based on a valuation of the land at $275 per square foot, a rate roughly six times the one used for the park appraisal, the one that appears to be without justification, according to principles of proper land valuation.

It appears that the $275 rate was derived from comparison to assessments on much smaller lots. Smaller lots, as we understand, are generally worth more per square foot. Lots located in much more expensive neighborhoods in other boroughs such as Manhattanville and Alphabet City, both located in Manhattan. New Yankee Stadium is located, in contract, in the south Bronx.

There is also substantial doubts to the $1 billion valuation of the stadium, itself, but here, too, it appears the city padded the assessment with questionable costs, including soft costs of $250 million, or 25 percent of stadium cost, which is high.

These findings and conclusions are consistent with the preliminary finding of the investigation conducted by New York State Assemblyman Richard Brodsky, a witness at today's hearing.

Finally, there is reason to question whether the projection of the tax assessments within the city's Development Agency provided to the IRS is based on an insupportable estimate of the future value of the stadium. Typically, sports stadiums lose some of their value over time as they become obsolete, a process that usually lasts less than 40 years, but the city makes the highly suspect claim that the stadium never depreciates. Rather, they assert that it gains 3 percent in the value a year through 2046. There is no decline in value projected.

Taken together, the consequence of these three assertions is an inflated assessment figure that allows the city to claim that the payments will be made by the Yankees for debt service and known as payments in lieu of taxes. That would satisfy the Treasury regulation that the IRS applies in its consideration of whether this project is eligible for tax-exempt bonds.

If the city properly assessed the value of the stadium site and the stadium, itself, most likely either a smaller stadium would have been built or the Yankees would have been forced to contribute a larger share of the cost of the project. The publicly financed share would have been smaller.

So the question this subcommittee is investigating is whether the New York Yankees and New York city officials collaborated in a scheme to mislead the Internal Revenue Service in order to pass more of the cost of a fancy new stadium onto the Federal taxpayers.

We had hoped that the representatives from the New York Yankees and New York City Industrial Development Agency, the key players arranging this deal, would have participated in this hearing and given us their perspective on the policy and factual issues.

But they weren't available, and to accommodate their schedules we will hear from those witnesses at a later date.

The assessment issues are complex and our inquiry is incomplete, in large part because the Yankees and the city have repeatedly failed to comply with our requests to produce documents about the assessments. But I anticipate that will change. We are going to continue our investigation.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

Opening Statement
Of
Dennis J. Kucinich, Chairman
Domestic Policy Subcommittee
Oversight and Government Reform Committee
Thursday, September 18, 2008
2154 Rayburn HOB
10:00 a.m.

"Gaming the Tax Code: Public Subsidies, Private Profits, and Big League Sports in New York."

This is the Domestic Policy Subcommittee's third hearing in the last year and a half on the federal government's subsidization of the construction of professional sports stadiums through the federal tax code. In our previous hearings, we showed that building sports stadiums does not make sense as a tool of taxpayer-subsidized economic development. From a state and local perspective, sports stadiums do not create jobs, and, in fact, they use resources that would be better expended elsewhere, such as on building schools and shoring up crumbling infrastructure. Rather, state and local governments compete with each other to lure or retain professional sports teams in a senseless race to the bottom for larger public subsidies subsidized by the federal taxpayer. As a result, not only are other, more important public safety projects ignored, such as repairing structurally deficient bridges and aging water distribution and treatment systems, but granting a federal tax-exemption to

bonds issued to build these stadiums means more stadiums and more expensive stadiums are being built than if there were no federal subsidy. Furthermore, stadiums are essentially private. Sports teams are privately owned by extremely wealthy individuals. The practice of providing taxpayer subsidies to the building of sports stadiums is a transfer of wealth from the many to the wealthy.

This Committee is charged with exposing waste, fraud and abuse. In the case of the new Yankee Stadium, not only have we found waste and abuse of public dollars subsidizing a project that is for the exclusive benefit of a private entity, the Yankees, but also we have discovered serious questions about the accuracy of certain representations made by the City of New York to the federal government. This Subcommittee's still ongoing investigation has uncovered substantial evidence of improprieties and possible fraud by the financial architects of the new Yankee Stadium. The stadium project has already benefitted from the issuance of over $940 million of tax-exempt bonds. The tax-exemption on these bonds will save the Yankees well over $100 million in interest costs, a subsidy that will cost federal taxpayers almost $200 million in lost tax revenues. The City is now requesting that the IRS approve over $360 million in additional bonds to allow the

Yankees to complete the stadium. These additional bonds would make the most costly publicly funded stadium in the United States even more exorbitant, all on the federal taxpayers' dime. At a minimum, our investigation has shown that these bonds should not be approved without further investigation.

Two wildly divergent valuations for the land under the stadium were submitted by City and State government officials to the federal government. In July 2006, the New York State Office of Parks submitted to the National Park Service an appraisal for $21 million of a 10.7 acre portion of McComb's Dam Park. This parcel constitutes the majority of the new Yankee Stadium site. State and federal law require that the City replace the park, which was destroyed to build the stadium, with one of at least equivalent value. The Park Appraisal arrived at the $21 million figure based on a rate of $45 per square foot. While land appraisals are complex, the Subcommittee has consulted with experts and has reached a provisional judgment that the Park Appraisal is, if not completely accurate, reasonable based on the comparable properties used to calculate value.

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scheme to mislead the Internal Revenue Service in order to pass more of the costs of a fancy new stadium onto the federal taxpayer.

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We will continue our investigation.

Mr. KUCINICH. The Chair recognizes Congresswoman Watson.

Ms. WATSON. I want to thank the Chair for today's hearing. At a time when the economy has been turned upside down, our banks are failing, foreclosures are abounding, the whole globe is upset because in this country we have allowed the upper class to destroy the middle class, and so this hearing is very necessary to examine whether the use of Federal tax codes to help build professional sports stadiums and arenas is in the best interest of the public.

The public wants to hear from us what are we going to do, and when we allow the rich to get richer—and certainly it is those who run sports organizations that are really reaping in the money.

Now, we are today specifically focusing on the use of federally tax exempt bonds to finance the New York Yankees and the New York Mets Stadiums, and the new stadium being built for the New York Mets.

The New York Yankees is valued at around $730 million. The New York Mets is valued somewhere around $482 million, and the New York Mets [sic] is valued at around $244 million. Looking at these numbers, I do not understand why these sports teams cannot fund the construction of their own stadiums and arenas. These are money-making facilities every time they are open. Why should the city have to do that?

I hope this hearing today will shed light on this issue.

An article that Forbes titled, "How About Them Cowboys" reported that the National Football League's average value of a franchise football team is nearly $1 billion. The owners of the Dallas Cowboys, and specifically Jerry Jones, owns the wealthiest franchise in the NFL and is currently building a $1 billion stadium in Texas that is a mix of public and private financing. Jones is already a billionaire and is having his stadium built with $325 million in taxpayers' subsidies.

How can we do that when people's savings are disappearing? How can we do that when we are paying for a war that is only taking our lives and our moneys and not giving anything back? How can we use $325 million of taxpayers' dollars?

The reason why my city, the city of Los Angeles, does not have an NFL football team is because our local government, thanks to them, does not want to use public funds to finance a stadium, and for good reason. The sports industry makes enough capital to finance their own construction of their own facilities.

Now, the Coliseum that they are looking at has next to it a school of science and industry, L.A. Unified School of Science and Industry. The parking is worth millions of dollars to keep that school open. They want the proceeds from the parking. They are not going to get them. I used to be on the board. I just want to make it real clear that at least our city council is smart enough not to give public money away to a franchise that makes more money than the whole board and the school district makes in a year.

Mr. Chairman, I don't believe that the use of taxpayers' dollars and the Federal Tax Code should be used to subsidize the construction of stadiums and arenas. It is not in the best interest of the American people, and at this time we are looking at a stimulus package to go out to the public, because that middle class who pays

taxes is being squeezed to the point of collapse, and I will not sit by and allow that to happen.

Thank you for having this hearing today.

Mr. KUCINICH. I thank the gentlelady.

We are joined by the gentleman from Massachusetts, Mr. Tierney. Mr. Tierney is recognized.

Mr. TIERNEY. I don't have an opening statement, Mr. Chairman. I am interested in the questions and answers and thank our witnesses for being present and you for having the hearing.

Mr. KUCINICH. I thank the gentleman.

We will continue by introducing our first panelist. Mr. Stephen Larson is the Associate Chief Counsel of Financial Institutions and Products of the Internal Revenue Service. Prior to this assignment, Mr. Larson served in the Office of Tax Policy at the Treasury Department, where he was Senior Advisor to the Assistant Secretary.

Mr. Larson began his service with Treasury in early 2004 in the Office of General Counsel as Acting General Counsel from July through December 2006. Before joining the Treasury Department, Mr. Larson was vice president and general counsel of Special Projects for CSX Corp., where he worked for over 12 years, and a partner at the Richmond, VA, firm of Christian and Barton specializing in corporate and financial matters.

I want to thank Mr. Larson for appearing before the subcommittee today.

I am going to note for the members of the subcommittee and for the public that while Mr. Larson is allowed to discuss IRS regulations, policies, and procedures, he is prohibited by 26 U.S.C. 6301 from discussing, directly or indirectly, information submitted by any particular taxpayer to the IRS. I just want to go over that one more time so we can all understand the ground rules of his participation. He is allowed to discuss IRS regulations, policies, and procedures, but he is prohibited by 26 U.S.C. 6103 from discussing, directly or indirectly, information submitted by any particular taxpayer to the IRS.

With that in mind, welcome. Mr. Larson, it is the policy of the Committee on Oversight and Government Reform to swear in all the witnesses before they testify.

[Witness sworn.]

Mr. KUCINICH. Let the record reflect that the witness has answered in the affirmative.

I would like Mr. Larson to give a brief summary of his testimony.

Try to keep it to 5 minutes, but bear in mind your complete written statement will be included in the hearing record.

Mr. Larson, you may proceed.

STATEMENT OF STEPHEN LARSON, ASSOCIATE CHIEF COUNSEL, FINANCIAL INSTITUTIONS AND PRODUCTS, INTERNAL REVENUE SERVICE

Mr. LARSON. Good morning, Chairman Kucinich, members of the subcommittee. I appreciate the opportunity to be here this morning.

My name is Steve Larson, and I am the Associate Chief Counsel, Financial Institutions and Products, with the Office of Chief Counsel of the IRS. The Office of Chief Counsel acts as the legal advisor

to the IRS Commissioner on matters related to the Internal Revenue laws and other legal matters. My division, Financial Institutions and Products, includes those lawyers with primary responsibility for tax-exempt bonds.

As a preliminary matter, I want to thank the chairman for his reference to Section 6103 of the Code. As you know, confidentiality of taxpayer information is critically important to the IRS.

With that caveat, I will be happy to provide whatever information I can.

Mr. Chairman, tax-exempt bonds have always been an important source of financing for State and local governments. Over time, Congress has limited the ability of State and local governments to use that tax exemption to subsidize private business activities. Currently, a so-called qualified private activity bond is entitled a tax exemption only if the proceeds from the bonds are used for limited purposes specified by statute.

In contrast, Congress has not placed similar restrictions on the use of proceeds of bonds payable from general governmental funds. In this context, general governmental funds include the proceeds of generally applicable taxes. It is this definition of generally applicable taxes and the payments made in lieu of those taxes that is the subject of both the existing and proposed regulations and is a key area of interest to this subcommittee.

The Office of Chief Counsel tries to interpret and administer the laws with respect to tax-exempt bonds fairly and equitably and tries to ensure that the exemption is used in ways that are consistent with prevailing law, the statutes, and congressional intent.

In that context, we were asked in July 2006 to review plans for two new sports stadiums to be funded in part by tax-exempt bonds, secured by fixed payments in lieu of taxes. Based upon the regulations in effect at that time, we issued two private letter rulings that allowed the plans outlined by those taxpayers to go forward.

However, those private letter rulings served to focus our attention on how broadly the existing regulations could be interpreted with respect to PILOTs. To address these concerns in October 2006 the Treasury Department and IRS published proposed regulations to tighten the standard for determining when PILOTs would be treated as commensurate with generally applicable taxes. The basic purposes of these proposed regulations is to require a closer structural relationship between eligible PILOT payments and generally applicable taxes.

Under the proposed regulations, a payment would be commensurate only if it is based on the amount of generally applicable real estate taxes that would otherwise apply to the property. This would also require that the PILOT payments be based on normal assessments using the same process as similar property subject to real property taxes. Downward adjustments would be permitted, but the net amounts would continue to fluctuate with changes in that hypothetical real estate tax. Accordingly, the proposed regulations would eliminate the ability of a State or local government to set PILOTs at a fixed amount that did not fluctuate with changes in the underlying tax.

The proposed regulations are on the recently released 2008–2009 Priority Guidance Plan, and we hope to issue a final regulation soon.

I thank you for this opportunity to appear this morning and will answer any questions that you may have.

[The prepared statement of Mr. Larson follows:]

WRITTEN TESTIMONY
OF
STEPHEN LARSON
ASSOCIATE CHIEF COUNSEL
FINANCIAL INSTITUTIONS AND PRODUCTS
INTERNAL REVENUE SERVICE
BEFORE
DOMESTIC POLICY SUBCOMMITTEE
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE

"THE STATE OF URBAN AMERICA AND THE USE OF TAX- EXEMPT BONDS"

Thursday, September 17, 2008
2154 Rayburn HOB
10:00 a.m.

Good morning Chairman Kucinich, Ranking Member Issa and Members of the Subcommittee. Thank you for the opportunity to be here this morning to discuss some of the uses of tax-exempt bonds by State and local governments.

My name is Steve Larson, and I am the Associate Chief Counsel, Financial Institutions and Products for the Internal Revenue Service (IRS). The office of the Chief Counsel acts as the legal advisor to the IRS Commissioner on all matters pertaining to the interpretation, administration and enforcement of the Internal Revenue laws, as well as all other legal matters. The Chief Counsel's office also provides legal guidance and interpretative advice to the IRS, Treasury Department, and the taxpaying public in general.

Before discussing the specific issues that are the focus of this hearing, it is important to emphasize two critical points. First, the IRS' mission is to oversee our nation's tax administration system. It does not develop tax policy proposals or take a position on them as part of the legislative process. Questions on tax policy issues are better addressed to the Treasury Department's Office of Tax Policy. In the tax policy area, the role of the IRS is limited to advising on the administrative issues that might arise from proposed tax legislation.

Second, in order to carry out its mission, taxpayer privacy is of critical importance. This is not just an internal mandate, but it is required by Section 6103 of the Internal Revenue Code (the Code), which prohibits the sharing of taxpayer information except in very limited circumstances identified in the Code. As a result, the IRS cannot respond to any question that could result in, or be perceived to result in, the sharing of confidential taxpayer information.

Tax-exempt bond financing plays an important role as a source of financing to State and local governments for public infrastructure projects and other significant public purpose activities. The IRS recognizes the importance of interpreting and administering the law with respect to this significant Federal subsidy in a fair and equitable manner to ensure appropriate targeting of this subsidy consistent with the relevant Code provisions and the Congressional intent in enacting those provisions of the Code.

This morning I will discuss private activity bonds, recent private letter rulings, and regulations that have been proposed to deal with issues associated with the issuance of tax exempt bonds.

Private Activity Bonds

In General

Under section 141 of the Code, bonds are classified as "private activity bonds" if more than 10 percent of the bond proceeds are both: (1) used for private business use (the "private business use test"); and (2) payable or secured from private business sources (the "private payments test") (together, the "private business tests"). Bonds also are treated as private activity bonds if more than the lesser of $5 million or 5 percent of the bond proceeds are used to finance private loans, including business and consumer loans. These tests are intended to identify arrangements that have the potential to transfer the benefits of tax-exempt financing to non-governmental persons.

Under the private activity bond definition, bonds are not classified as private activity bonds unless the bonds meet both prongs of the private business tests (i.e., both the private business use test and the private payments test). Thus, even if bonds finance a project that is 100-percent for private business, that private business use will not cause the bonds to be treated as private activity bonds absent sufficient private payments or security to meet the private payments test. For example, a State or local government may issue tax-exempt governmental bonds (which are not classified as impermissible private activity bonds) to finance a stadium that a private professional sports team uses, provided that the private payments that the issuer receives from the team or from other private businesses do not in the aggregate exceed the private payments test (i.e., 10 percent). Instead, in these circumstances, the issuer may subsidize this financing by paying the debt service on the bonds with its general governmental funds or generally applicable taxes, which are not treated as private payments.

The Private Business Use Test

The private business use test is met if a private business uses more than 10 percent of the proceeds of an issue. Private business use generally arises when a private business has legal rights to use the bond-financed property. These legal rights to use bond-financed property that trigger private business use include cases in which a private business owns, leases, manages, enters into an output contract, or enters into certain research agreements or other comparable arrangements that convey special legal entitlements to the financed property. There are a number of exceptions and safe harbors with respect to the private business use test that allow limited private business use of bond-financed property in prescribed circumstances.

The Private Payments Test

The private payments test considers the source of payment on, or nature of the security for, the debt service on a bond issue. In particular, the private payment portion of the test takes into account the payment of debt service that is directly or indirectly derived from payments with respect to property used by a private business. For example, if a private business pays rent for its

use of the bond-financed property, the rent payments can give rise to private payments. Just like the private business use test, there are exceptions to the private payments test.

The Generally Applicable Taxes Exception to the Private Payments Test

One exception to the private payments test applies to payments from generally applicable taxes. Congress indicated in the legislative history of the Tax Reform Act of 1986 that revenues from generally applicable taxes should not be treated as private payments for purposes of the private payments test.

Treasury Regulations define a generally applicable tax as an enforced contribution imposed under the taxing power that is imposed and collected for the purpose of raising revenue to be used for a governmental purpose. A generally applicable tax must have a uniform tax rate that is applied equally to everyone in the same class subject to the tax and that has a generally applicable manner of determination and collection.

Treasury Regulations provide that generally applicable taxes do not include "special charges" for special privileges granted or services rendered. Examples of special charges include payments for special privileges granted or regulatory functions (e.g., license fees), services rendered (e.g., sanitation fees), uses of property (e.g., rent), or special assessments to finance capital improvements that are imposed on a limited class of persons based on benefits received from the capital improvements financed with the assessments.

Although taxes must be determined and collected in a generally applicable manner, the Treasury Regulations permit certain agreements to be made with respect to those taxes. An agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose is such a permissible agreement. For example, an agreement to abate taxes to encourage a property owner to rehabilitate property in a distressed area is a permissible agreement.

In addition, under an exception to the private payments test, the Treasury Regulations treat certain "payments in lieu of taxes" and other tax equivalency payments ("PILOTs") that closely resemble generally applicable taxes in the same manner as generally applicable taxes. Under the current Treasury Regulations, a PILOT is treated as a generally applicable tax if the payment is "commensurate with and not greater than the amounts imposed by a statute for a tax of general application." For example, if the payment is in lieu of property tax on the bond-financed facility, it may not be greater in any given year than what the actual property tax would be on the property.

In addition, to avoid being a private payment, a payment must be designated for a public purpose and not be a special charge.

Recent Private Letter Rulings and Proposed Regulations

Difficult interpretative issues arise when a payment is imposed in a customized fashion on a private business that uses bond-financed property. In these cases, the Office of Chief Counsel must determine whether a payment is a generally applicable tax within the exception from the

private payments test, or is instead more like a lease, rent or other payment that should be treated as an impermissible private payment under the private payments test. This line becomes particularly difficult to draw when the tax is abated through negotiations or is a PILOT that is crafted for the transaction and essentially results in debt service being fully paid by the private business.

In July of 2006, the Office of Chief Counsel issued two favorable Private Letter Rulings on tax-exempt governmental bond financings for stadiums. The facts in these rulings involved professional teams that were going to use the stadiums, so the private business use test was met. The question presented in the rulings was whether payments to be made by the teams and to be used for debt service on the bonds would constitute PILOTs treated as generally applicable taxes or would constitute private payments.

The payments were structured to qualify as PILOTs under State and local law but were set at a fixed amount by agreement between the team and the local government. The fixed amount was expected to exceed the debt service on the bonds, but was not permitted to exceed the amount of property taxes that would be imposed upon the stadium if the stadium were subject to tax. We concluded that the existing Treasury Regulations supported a favorable response to the taxpayers. These private letter rulings served to focus our attention on how broadly the existing regulations could be interpreted to permit PILOTs to be used to pay debt service on tax-exempt bonds in situations where the PILOTs bear an insufficient link to the otherwise generally applicable tax, and in fact closely resemble the expected debt service on the bonds.

To address these concerns, in October of 2006, the Treasury Department and the IRS published Proposed Regulations to clarify and to tighten the standard for determining when PILOTs would be considered to be commensurate with generally applicable taxes. The basic purpose of these Proposed Regulations was to modify the standards for the treatment of PILOTs as generally applicable taxes to better assure a reasonably close relationship between eligible PILOT payments and generally applicable taxes.

Under the Proposed Regulations, a payment is commensurate only if the amount of the payment represents a fixed percentage of, or a fixed adjustment to, the amount of generally applicable taxes that otherwise would apply to the property in each year if the property were subject to tax. For example, a payment is commensurate with generally applicable taxes if it is equal to the amount of generally applicable taxes in each year, less a fixed dollar amount or a fixed adjustment determined by reference to characteristics of the property, such as size or employment. The Proposed Regulations permit the level of fixed percentage or adjustment to change one time following completion of development of the property. Accordingly, the Proposed Regulations would essentially eliminate the ability of a State or local government to set PILOTs at fixed amounts that do not fluctuate with changes in the underlying taxes on which the PILOT is based.

The Proposed Regulations further provide that eligible PILOT payments must be based on the current assessed value of the property for property taxes for each year in which the PILOTS are paid, and the assessed value must be determined in the same manner and with the same frequency as property subject to generally applicable taxes. A payment is not commensurate if it

is based in any way on debt service on an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property.

The Proposed Regulations also eliminate the sentence in the existing regulations that provides as an example of a special charge a PILOT paid in consideration for the use of property financed with tax-exempt bonds. This proposed change represents a technical clarification rather than a substantive change. A payment made "in consideration for the use of property" is more properly characterized as rent or an installment sale payment. Such a payment for the use of property is treated under the "special charge" limitation on generally applicable taxes. In addition, the reference to tax-exempt bond financing in this example caused confusion because the presence or absence of tax-exempt bond financing is irrelevant to the determination of whether a payment, in substance, is in the nature of a special charge for the use of property or a generally applicable tax.

The Office of Chief Counsel and Treasury Department have received numerous public comments on the Proposed Regulations. We have included the finalization of the Proposed Regulations on the 2008-2009 Priority Guidance Plan, which was released on September 10, 2008. We plan to issue final regulations soon on the treatment of PILOTs, with appropriate modifications based on the public comments received.

Summary

Mr. Chairman, I hope my testimony this morning illuminates the IRS role in the issuance of tax-exempt bonds by State and local governments. The issues that I have discussed this morning are particularly complex.

It is important to remember that our role is to administer the tax laws. We do our very best to apply the laws the Congress passes in a fair and equitable manner consistent with Congressional intent. We recognize the importance of administering the tax law in this area in a manner to ensure appropriate targeting of this significant subsidy consistent with the statute and Congressional intent.

Thank you again for the opportunity to appear this morning and I will answer any questions that you may have.

Mr. KUCINICH. I thank Mr. Larson.

Sir, broadly speaking, do you generally verify factual recitations made in applications to the IRS for private letter rulings?

Mr. LARSON. As we recite as a regular basis in the actual responses to private letter rulings, the Chief Counsel's Office is effectively just a large law firm. We have no audit function, and so we specifically advise taxpayers that we have relied upon their statements, that we have not verified their statements, although the facts are subject to later verification. But we do not, ourselves, verify it.

I will say that in my experience it is extremely common, if facts in a PLR are just confusing, don't seem to make sense, would seem out of whack based on just the general knowledge of the examiner, we will frequently ask for clarifications. But at the end of the day——

Mr. KUCINICH. So there is a followup? If it doesn't make sense, you followup?

Mr. LARSON. Yes. During the PLR process if it does not make sense we will ask for clarification and ask for further information.

Mr. KUCINICH. Do you ever ask people to basically affirm or swear that the information they are presenting is true?

Mr. LARSON. They actually, all of it is submitted to us under penalties of perjury, and so we don't ask them anything beyond that, but they do submit everything under penalties of perjury. Most of the questions, frankly, tend to be in the nature of clarification. The examiner will look at it and say I just don't understand what you are really doing here. Can you tell me some more?

Mr. KUCINICH. Again, broadly speaking, after a private letter ruling has been issued, how would or could the IRS come to suspect that factual recitations that were made to support a private letter ruling might be false? And what procedures would be followed to investigate suspicions of factual inaccuracies?

Mr. LARSON. The process for verifying factual assertions would come up in the course of an audit of the underlying tax-exempt bonds, and the Chief Counsel's office, as I say, functions as a law firm. We do not perform the audit function. We have no investigatory staff, but the IRS audit side does and is actively involved in that process, and there are a substantial number of auditors who are assigned specifically to tax-exempt bonds.

Mr. KUCINICH. Well, let's say that someone gave you factual recitations to obtain a private letter ruling from an applicant seeking tax-exempt treatment for bonds. What would be the consequences if the IRS ultimately concluded that these factual recitations that were the basis of you making a private letter ruling in order to get tax-exempt bonds were false? What would happen?

Mr. LARSON. Again—and, of course, we are speaking broadly about the process—if the IRS examiners were to find that facts that had been given to obtain the PLR were false, that would become part of their audit findings. It would depend, of course, whether the falsity of those facts was material. Would it have changed the result had we known what the correct facts were? But assuming that they were material, the PLR, the private letter ruling, is only valid to the extent that it is based on accurate factual recitation. So if the audit team were to determine that the underly-

ing representations were false, then the PLR would no longer be effective and the audit team would pursue its normal recourse.

Mr. KUCINICH. What happens if someone makes false representations to the IRS on matters of material import with respect to the information that you need in order to make a ruling?

Mr. LARSON. As I said, the factual information we receive is submitted under penalties of perjury. What happens with respect to the person making that is really a matter of criminal law and is outside of my area.

Mr. KUCINICH. I thank the gentleman.

Ms. Watson.

Ms. WATSON. Thank you, Mr. Chairman.

Mr. Larson, can you explain for us how the requirement that a PILOT be designated for a public purpose is interpreted under Federal law?

Mr. LARSON. Yes. The way that the tax-exempt bonds are structured, there is a bifurcation between private activity bonds, to take us back a step, there was a time when a State or locality could issue bonds and allow the proceeds to be used by private industry, anybody they wanted to.

Ms. WATSON. There was a time.

Mr. LARSON. There was.

Ms. WATSON. Do they still have that provision?

Mr. LARSON. That has been pared back very substantially, so that is now true only for a limited class of things that are limited by statute.

I think the answer to your question is that, in the context of true governmental bonds—that is, bonds that a municipality or a State is paying from its own resources—the language about for a public purpose is designed really to just differentiate between the types of bonds that are for a private purpose and those that are public. So really that language is taken to mean that a governmental entity has decided that it is willing to spend its own money on the project, if it does. If a State or locality says this is something I am willing to spend the money on, it really is a matter of federally. We are not in a position to second-guess them as to whether that was a wise use of the funds.

Ms. WATSON. Well, is it fair to say that the PILOT need not be designated for a Federal public purpose?

Mr. LARSON. That is a fair statement. We have no Federal public purpose standard in this area. It is simply a matter of looking through to the State and locality for what it views to be a public purpose right now.

Ms. WATSON. In your testimony you state that the public purpose of the proposed regulations was to modify the standards for the treatment of PILOT as generally applicable taxes to better assure a reasonable close relationship between eligible PILOT payments and generally applicable taxes. How do the proposed regulations and their changes in the commensurate standards specifically advance this goal?

Mr. LARSON. Madam Congresswoman, they advance it directly in this way: that the generally applicable tax that we really are talking about mostly in connection with bonds is real property tax. It is the normal real estate tax that municipalities and States apply

to property in their jurisdictions. What the new proposed regulations would do when they went into effect would be to require that a PILOT be structured in almost identically the same way that true actual real estate taxes are structured.

It could not be just a fixed flat fee; it would have to be an amount that starts with the tax rate applied to other property that is based on assessments that are made in the same way as other property in the area of a similar type, and, in particular, coming at it from the other side, would make it clear that it cannot be calculated using debt service as the base.

Ms. WATSON. In proposing changes to the PILOT rule, did IRS consider whether a PILOT structured in a way that meets the proposed regulations be viable in today's bond market?

Mr. LARSON. By today's bond market I am not sure anyone knows what could be viable. To speak more broadly to what we thought at that time and what we hope are more normal sorts of markets, we are certainly not experts in the marketing of bonds. That is why there is public comment.

Ms. WATSON. You don't have to be an expert on marketing bonds, but look at Wall Street today. We are talking about some projects near Wall Street in New York that makes me very, very nervous to have taxpayers' money put into the construction of those PILOT projects.

I think that you have responded in such a way that adds to more questions, so I will just give back my time, Mr. Chairman.

Mr. KUCINICH. I thank the gentlelady.

We are going to just have one more round of questioning of Mr. Larson. For those who just tuned in, we speak of PILOTs, and we are not talking about people who fly planes. We are talking about tax schemes that may not fly, and it is payment in lieu of taxes.

I always like to remind the staff that here in acronym city, D.C., it is good to explain terms.

Mr. Larson, the proposed PILOT regulations add new requirements that the payment must be based on the current assessed value of the property for each year in which the PILOTs are paid, and that the assessed value must be determined in the same manner and the same frequency as property subject to generally applicable taxes.

To what extent were those requirements implicit in the current payment in lieu of taxes rule?

Mr. LARSON. They would have been implicit only in a very indirect sense in that the existing regulations do require that a PILOT not exceed the amount that would have been paid under the normal real estate taxes in effect. So presumably it would only really be at the time of a challenge. Only if someone were challenging the validity of a payment would there be a need to actually go in and do the appraisal and calculate that hypothetical tax. It may be that municipalities would have done that, but there was nothing in either the regulations or implicit in those regulations that would have required it more frequently.

Mr. KUCINICH. In your testimony you state that the basic purpose of the proposed regulations was to modify the standards for the treatment of payment in lieu of taxes as generally applicable taxes to better assure a reasonably close relationship between eligi-

ble payment in lieu of tax payments and generally applicable taxes. How do the proposed regulations, changes in the commensurate standard, specifically advance this goal?

Mr. LARSON. They advance this goal by requiring that a PILOT, to qualify under the proposed regulations, really must be calculated in essentially the same way that true real estate taxes would be calculated; that is, that you must look at the appraised value, you must apply a rate, and, as with a true real estate tax, the municipality is entitled to permit a form of tax abatement, but that abatement has to be either a percentage or a fixed amount off the top. It will still have to leave the amount fluctuating with changes in the underlying taxes and the appraisal.

Mr. KUCINICH. Is there anything in the payment in lieu of taxes rule or the proposed regulations that is designed to ensure that the process by which a payment in lieu of taxes is approved at the State and local level is democratically accountable and transparent? Broadly speaking, do you generally verify factual recitations made in applications to the IRS for private letter rulings?

Mr. LARSON. I think there are two elements, as I understood your question. I think, as I had testified earlier, we are not in a position to really verify factual recitations, although we do question ones that seem to be facially questionable. We do not have any rules and would not view ourselves as having the authority to question the procedure by which a State or local government made the decision to spend generally applicable tax revenues on a particular project.

So, unlike the private bonds where there are hearing requirements and we do have procedures, if you are talking about a governmental bond, which are the bonds that we are talking about here in this hearing, we do not. We leave that to the State and local government and the elected officials in those areas.

Mr. KUCINICH. You know, if, for example, a factual recitation was made with respect to, let's say, the value of land, turned out to be wildly disparate, is that something that the IRS takes notice of if that valuation of the land was substantive enough in the issuing of a private letter ruling?

Mr. LARSON. I think, here again, we are getting to a point that, given what is in the papers recently, we have a fact pattern that is awfully closely tailored.

Mr. KUCINICH. I will withdraw it.

Mr. LARSON. I believe I can answer it more broadly. I mean, the IRS does read the papers, it does look at things that are publicly known. The auditors get their information from whatever credible sources are available.

Mr. KUCINICH. Thank you. What factors do the IRS and the Treasury Department typically take into consideration when choosing an effective date for tax regulations?

Mr. LARSON. I suspect, Mr. Chairman, this is very much like the same source of concerns that Congress takes into effect when it chooses effective dates. We issue thousands of regulations covering large numbers of situations, and so we make a real effort to try to be fair and equitable. We look at expectations of the people being affected. We look at what is fair. So when you get down to ques-

tions of effective dates that are prospective, retroactive, these are all factors that we take into account, but there is no set answer.

Mr. KUCINICH. I thank the gentleman.

We have been joined by the gentleman from Maryland, Mr. Cummings. Welcome.

Does Ms. Watson have any other questions on this round before we go to Mr. Cummings?

Ms. WATSON. Just a comment, because I come from Los Angeles and the State of California, we have Prop 13, and we have been arguing for decades now to split the role because commercial facilities and sites maintain, whereas the assessed valuation was based on 1976, and so that fluctuates. And so we have some complications, so I guess this would be an issue that we would really have to raise locally in State issue about the tax because of our own propositions and the way they control the assessed valuation of property.

Mr. LARSON. I believe you are right, Congresswoman.

Ms. WATSON. I am trying to weed through all this, and it really gets complicated with the laws that we pass.

Mr. LARSON. Right. And the proposed regulation would simply say that for a PILOT to be effective and usable, it would have to fit within that same regime.

Ms. WATSON. Conform. Yes.

Mr. LARSON. Right.

Ms. WATSON. Thank you.

Mr. KUCINICH. I thank the gentlelady.

The Chair recognizes the gentleman from Maryland, Mr. Cummings.

Mr. CUMMINGS. Mr. Chairman, I will just wait until the next panel.

Mr. KUCINICH. I thank you, Mr. Cummings.

Thank you, Mr. Larson, for your presence here. I am grateful for it.

We are now going to move on to our next panel.

We are fortunate to have an outstanding group of witnesses on our second panel.

Mr. Richard Brodsky represents the 92nd Assembly District of the State of New York. Assemblyman Brodsky serves as chairman of the Committee on Corporations, Authorities, and Commissions of the New York State Assembly, which oversees the State's public and private corporations. This includes jurisdiction over business corporation law and telecommunications, as well as all public authorities, such as the MTA, the Throughway Authority, the Public Service Commission, the Port Authority, and the Lower Manhattan Development Corp.

From 1993 until 2002 Assemblyman Brodsky served as chairman of the Committee on Environmental Conservation, and prior to this as chairman of the Committee on Oversight, Analysis, and Investigation.

Assemblyman Brodsky is the recipient of numerous awards from local groups for his dedication to public interest and legislative achievements.

Welcome, Assemblyman Brodsky.

We will also hear from Professor Clayton Gillette. Professor Gillette joined the New York University School of Law faculty in 2000. For the prior 8 years he was the Perre Bowen professor of law at the University of Virginia School of Law. Professor Gillette began teaching at Boston University School of Law, where he served as the school's associate dean and the Warren scholar of municipal law.

Professor Gillette's scholarship focuses on commercial law and local government law. He is the co-author of several case books, including Local Government Law, Payment Systems and Credit Instruments, and a textbook on Municipal Debt Finance Law.

Professor Gillette has also written numerous articles on topics including long-term commercial contracts, relations between localities and their neighbors, and the privatization of municipal services.

Finally, Mr. Brad Humphreys. Professor Humphreys is an associate professor in the Department of Economics at the University of Alberta, where he also serves as their chair in the Economics of Gaming. Professor Humphreys conducts research for the Alberta Gaming Research Institute. Before joining the faculty at the University of Alberta, he was an associate professor at the University of Illinois Urbana-Champaign and had spent 10 years on the faculty of the University of Maryland Baltimore County in the Department of Economics.

Professor Humphreys' research areas include the economics of sports and sport finance. He has written about the economic impact of professional sports teams and has co-authored the paper "Caught Stealing: Debunking the Economic Case for D.C. Baseball," which was published by the Cato Institute. The professor also co-edited "The Business of Sports" published earlier this year.

Professor Humphreys is co-editor of Contemporary Economic Policy and associate editor of the International Journal of Sport Finance.

Gentlemen, it is the policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify. I would ask that you rise and raise your right hands.

[Witnesses sworn.]

Mr. KUCINICH. Let the record show that the witnesses have answered in the affirmative.

As with the first panel, I ask that each witness do their best to give an oral summary of your testimony, and try to keep it under 5 minutes in duration. I am not here with a hammer to enforce that, but give it a try. I just want you to know that your entire statement will be placed in the record of this hearing.

The reason why we try to keep these statements short is that the statements that we get we read beforehand, and the Members have questions that will help elucidate some of the issues that you bring to the committee.

Assemblyman Brodsky, thank you for being here. We would like to start with you. You may proceed with your statement. Thank you, sir.

STATEMENTS OF ASSEMBLYMAN RICHARD L. BRODSKY, 92ND ASSEMBLY DISTRICT NEW YORK STATE; PROFESSOR CLAYTON GILLETTE, NEW YORK UNIVERSITY SCHOOL OF LAW; AND PROFESSOR BRAD R. HUMPHREYS, DEPARTMENT OF ECONOMICS, UNIVERSITY OF ALBERTA

STATEMENT OF RICHARD L. BRODSKY

Mr. BRODSKY. Thank you, Mr. Chairman and members of the subcommittee. I am pleased to be able to transmit to you today a full copy of the committee report on the decision by New York City to subsidize the new Yankee Stadium. The report is based on previously secret and undisclosed documents, sworn testimony before committees of the legislature, and direct discussion with involved public and private persons. It sets for the action of New York city officials and others in the achievement of a package of public benefits to the New York Yankees totaling about $1 billion.

The report concludes that, in spite of public claims by elected officials and the Yankees, there are almost no new permanent jobs created, no new economic activity in the impacted communities. The bonds we use for private benefit, the public is paying the cost of repayment of those bonds and of construction of the stadium. Massive ticket prices announced by the Yankees were never a concern of the public officials who set forth the public conditions for the subsidies, and instead of dealing with that issue, city officials used bond proceeds to purchase a luxury suite at Yankee Stadium, itself.

In spite of State law requirements that there be a measurable public benefit in exchange for these massive public subsidies, such benefits do not exist. The tax system was manipulated in order to make the deal financially viable.

I will be glad to answer specific questions on these matters of State concern to the extent you wish me to do that. They are outlined at length and the documentary evidence behind them are cited at length in the interim report.

There is a growing national consensus that public financing of private sports facilities serves no useful public purpose. The New York City model is whatever additional proof needs to be offered behind that assertion. Whatever the emotional and political benefits of sports facilities, there is no public benefit that has been put forward in the process of approval.

There is a second concern about the specific proposed regulation, IRS regulation. Let me note one caveat. I come from a State that sends to Washington, DC, about $80 billion more than it gets back. The only supportable reason for this given in New York and elsewhere is that anything that addresses the imbalance of payments is in New York's interest. That is not a trivial argument, but, given that the benefits here are not flowing to the public but to a wealthy private corporation headquartered in Ohio and to people who don't live in New York, my objections to the deal stands, notwithstanding my concern about the balance of payment issues.

The IRS regulation will deal with a fundamental fact dealing with the explosion of public debt around the Nation. It is not being done by elected officials; it is being done by off-book entities such as public authorities, local development corporations, things not

under the normal control of elected officials and not normally subject to debt restrictions of a kind that others have. That is not good public policy and should stop.

The third Federal concern has to do with specific evidence uncovered in our investigation with respect to the private letter ruling issued by the IRS. The IRS questioned the city. The city swore that the property would be handled as would any other taxable property in the city of New York in the same class. The statements making those representations are included in my testimony and in the report.

In the end that is not what happened. The city inflated the value of the land underneath the stadium and the stadium facility, itself, for reasons that I can suspect but can't yet prove. The bottom line is that on the land value, while the surrounding area is assessed $9, $20, $30 and $40 per square foot, the land under Yankee Stadium is assessed at $275 a square foot. The procedures they used to come to this inflated conclusion include not dealing with comparables in the same county; accepting unverified numbers; calculating the site at 17 acres, although it was only 14.5 acres; failure to adjust, as professional and legal requirements are, for changes in value; and, most damning, the city did two separate assessments for different Federal and State purposes.

In order to assure that the park land under Yankee Stadium which was being taken from the community would be replaced by park land of equal value, the city was required to do an assessment. Instead of telling them about the $204 million number, which would have required $204 of park land back in, they did another assessment and came in at $21 to $28 million, depending on how you read it.

The second appraisal was done based on a State requirement of a statute I wrote. That came in at $40 million.

Where the city had an economic interest in a lower appraisal, it went out and found that; where there was an apparent interest in a higher appraisal, it found a way to get that done.

One final observation. This whole mess is the consequence of a fundamental flaw in Federal policy. Put aside the chairman's questions to the IRS about whether they ever independently verified whether there was a valid public purpose to the tax expenditures through the tax exemption process. We have created a system, the Congress and the administration have created a system that pits States against each other. That is marked by an elegant blackmail by powerful economic interests who threaten to leave.

There is no national interest in having the Government of the State of New York gleefully announce that he has persuaded by the use of taxpayer money a company to leave Maryland or Ohio or California and come to New York. That is a net no-gain for the national economic interest. Yet, that very pirating and blackmail is the consequence of the unmitigated subsidies in these sorts of deals.

I urge the Congress to finally end that and to no longer permit the tax exemption policies of the national government to be used as ways to whip-saw States into lowering their taxes for special, private, and usually powerful interests.

Thank you very much for this opportunity to present the interim report and our findings to the committee. I will be glad to answer any questions you may have.

[The prepared statement of Mr. Brodsky follows:]

THE ASSEMBLY
STATE OF NEW YORK
ALBANY

RICHARD L. BRODSKY
Assemblyman 92ND District

Westchester County

CHAIRMAN
Committee on
Corporations, Authorities
and Commissions

Testimony of Assemblyman Richard Brodsky

Mr. Chairman and Members of the Sub-Committee:

I am pleased to be able to transmit to you a copy of the Interim Report into Public Financial Assistance for the New Yankee Stadium, and to testify on the federal issues involved in the Stadium project.

The Report is based on previously secret and undisclosed legal documents, sworn testimony before Committees of the Legislature, and direct discussion with involved public and private persons. It sets forth the actions of various public and private parties as the New York Yankees and public officials sought and achieved a package of public benefits that total about one billion dollars. The Report concludes that, in spite of public claims by elected officials and the Yankees, there are almost no new permanent jobs, private investment, or local economic impact resulting from the taxpayer subsidies, the bonds were used for private benefit[1], and that the public is paying for the cost of construction of the new Stadium.[2] The Report further finds that the massive ticket prices announced by the Yankees, which will make Yankee games largely unaffordable to the very taxpayers who are paying for it, could have been mitigated if City officials had made affordable ticket prices a condition of the massive subsidies. The City refused to do so, instead, the using bond proceeds to acquire a luxury suite for its own use. City officials also manipulated state laws requiring that there be a measurable public economic benefit in exchange for taxpayer subsidies of private persons, state laws guaranteeing the integrity of our park system, and state and city laws that require the fair, professional and

[1] The City admits that the Yankee bonds are for a private benefit, saying that "...the transaction results in private business use of the proceeds of the Tax Exempt Bonds." (February 1, 2006 letter from Mitchell Rapaport and Bruce Serchuk (IRS) to the IRS. Page 47) The IRS acknowledged this as well, stating that "...all of the Stadium is reasonably expected to be used for a Private Business Use." (Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of The IRS Code of 1986. Page 15, Section d.2)

[2] "The City has determined to use its property taxes (in this case PILOTs) to finance the construction and operation...of the Stadium." (February 1, 2006 letter from Mitchell Rapaport and Bruce Serchuk (Nixon Peabody) to IRS. "NYCIDA – Request for Private Letter Ruling Under Section 141 of the Internal Revenue Code." Page 47.)

equal assessment of taxpayer property. I would be glad to cite the specific legal documents that are the evidence for these findings.

These serious failures of law and public policy are generally matters of state concern. I'm glad to further address them, and they do have some relevance to the federal issues before the Sub-Committee. But I now, in somewhat more detail, turn to issues of direct federal concern.

There is a growing national consensus that public financing of private sports facilities serves no useful public interest. The evidence we uncovered with respect to the Stadium deal is that there is little, if any, economic benefit to the public resulting from taxpayer subsidies. At a time when we are unable to fund our most basic infrastructure needs, the subsidization of sports facilities is not in the public interest and should cease. I urge the Congress, the Administration, and federal agencies to adopt this important reform.

There is a second concern about the proposed IRS regulation and its' impact on public financing of sports facilities. One caveat needs to be noted. As a citizen and representative of the State of New York, I'm keenly aware that the policies of the federal government result in my state receiving over $80 billion dollars less than our taxpayers send to Washington, while most other states receive more than they send. The only reason for the Stadium deal that stands scrutiny is that any arrangement that returns tax dollars to New York remedies the unfairness of the current system. The fact that these public dollars flow to the Yankees, a private, hugely successful and wealthy corporation not located in New York is a disturbing fact, but I must in fairness note the interests of my state in a fairer distribution of federal money. Notwithstanding these observations, the proposed IRS regulation should be adopted because it limits the transfer of public dollars into private pockets and because it begins to deal with the problem of use of PILOTs (Payments In Lieu Of Taxes) to create massive new public debt outside of existing debt restrictions. Public debt should be issued by public officials, with public scrutiny and control. IDAs and other "off-book" entities have created an explosion of public debt paid for by taxpayers with little legal foundation, in deals like the Stadium deal all across New York and elsewhere. The IRS and the Congress need to stop this.

The third federal concern has to do with specific evidence uncovered in our investigation with respect to the Private Letter Ruling issued by the IRS in 2006 permitting the initial bonds to be declared tax-exempt. The IRS repeatedly questioned the City to assure that the "Private Payment" standard would be satisfied. That standard requires that a PILOT payment used to repay tax-exempt bonds be no greater than the property tax payment it replaces. An artificially high PILOT is a device to get tax-exempt financing that the IRS will not permit.

The City swore to the IRS that the PILOT would not exceed the property tax bill otherwise owed, and that the assessment of the property would be the normal and customary assessment that any other taxpayer would receive.[3]

The evidence uncovered in our investigation shows that these promises were not kept. The New York City Department of Finance, at the request of City and NYCIDA officials, did an assessment that significantly inflated the value of the land and the Stadium itself. With respect to the value of the underlying land it assessed the value of the land at $204 million, or $275 per square foot and the Stadium facility at $1.025 billion, for a total assessed value of $1.229 billion. It used a number of questionable, unusual, and indefensible practices to do so.

First, it compared the value of the Stadium land to parcels in Manhattan, where land values are much higher than in the Bronx, and contrary to written assertions used Manhattan land from as far away as the Lower East Side where land values are astronomical. This substantially inflated the value of the Stadium land.

Second, although it correctly adjusted the Stadium land value upward because of the passage of time, it did not adjust the value down because of disparate parcel size, and parcel location. These are all standard adjustments, but the City used only the adjustment that increased value and did not use the adjustments that decrease value. This substantially inflated the value of the Stadium land.

Third, the City calculated the assessed value for the land under the Stadium based on acreage of 17 acres. The actual acreage is 14.5 acres. A correction was not done for over one year, and the IRS was not notified of the change. This substantially inflated the value of the Stadium land.

Fourth, the City accepted unverified numbers for the cost of the Stadium itself, provided to it by the Yankees investment adviser. It is standard practice to use only "certified" cost estimates provided by certified professionals, usually engineers. The use of uncertified numbers is unusual and inconsistent with the promise to treat the Yankees as any other taxpayer.

Fifth, the City accepted categories of Stadium cost not usually included in assessed value calculations. These included furnishing and fixtures not normally allowed, and apparently duplicated some categories of cost such as "Contingency' and "Project Escalation." If these prove to be duplicate categories it will have resulted in an inflated assessment.

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[3] "...the City...will use the same assessment method for the Stadium is *(sic)* used for assessing properties of the same class within the City..." (July 3, 2006 letter from Mitchell Rapaport and Bruce Serchuk (Nixon Peabody LLP) to Rebecca Harrigal (IRS). Page 2)

Sixth, a review of land values in the area surrounding Yankee Stadium shows a per square foot value a tiny fraction of the value given the land by the City. These other parcels, which were ostensibly valued by the City using normal assessment procedures, include residential, parkland, commercial, retail and other public and private uses. Their assessed value ranges from $9 to $60 per square foot, with most parcels in the $15-$30 range. This contrasts with the $275 per square foot value given to the land beneath the Stadium.

Seventh, as part of the deal the City did two additional assessments of the land beneath the Stadium that valued the land at a small fraction of the value given to the IRS, and kept these appraisals secret.

The second appraisal[4] was done because the National Park Service and the laws of New York require that the parkland taken to build the new Stadium be replaced by parkland of equal value. If the City had told the NPS or the State that it had valued the Stadium land at $204 million it would have to find $204 million to replace it. It apparently did not want to spend that kind of money, so it contracted for a different appraisal. Properly using comparable parcels in the Bronx, that appraisal showed the land to be worth $21-28 million, and that number was given to the NPS and the State as the value of replacement parkland. The IRS was not told of second assessment of $21 million, and the NPS and the State were not told of the City assessment of $204 million.

The third appraisal[5] was done as a consequence of a state law requiring appraisal of property disposed of without public bidding. That appraisal, using slightly different methods showed the land to be worth $40 million. The NPS, the state, and the IRS were never informed of the existence of this appraisal.

These seven factors, taken separately or together, are powerful evidence that the assessed value of Yankee Stadium was artificially inflated by at least one-third, that this inflation was, contrary to sworn promise by the City to the IRS, the result of assessment actions that are not those applied to other taxpayers.

We were disturbed by the evidence of these assessment practices, and their ramifications for the existing tax-exemption, any future tax exemptions, the IRS proposed regulation, and the broader concern that must be felt by any taxpayer viewing the enormous disparities in value that appear embedded in the City's assessment roll. The Committee is continuing its investigation of these actions. Whether or not they are of interest to the IRS, the Congress, bondholders or other investigative bodies is not yet apparent.

Let me conclude with a final observation. There is a fundamental flaw in the decision by the Congress to allow for tax-exemptions that benefit private persons. The most obvious

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[4] The "Appraisal Report of Vacant Land (Macombs Dam Park" done for NYC Department of Citiwide Administrative Services by Patjo Appraisal Services, Inc. find the land value to be $21 million.

[5] The "Appraisal of Future Yankee Stadium Site" done for NYCEDC by Grubb & Ellis Consulting Services Company, effective July 1, 2006, finds the land value to be $40 million.

consequence of this policy is to create an economic development model that creates little new economic activity on a national basis. You have created a system that pits one state against another, that is marked by the elegant blackmail of private interests who receive subsidies and tax breaks not because of new investment, but because they threaten to leave one state for another. From a national perspective, it does the country no good when the Governor of New York gleefully announces that as a result of tax-exempt bonds he has persuaded an employer to move from Pennsylvania. The federal system was not envisioned as a vehicle for cutthroat competition for tax preferences between and among states and large economic interests. The Congress should stop the madness and restore fairness and equity to our tax system by denying tax-exemptions whose purpose is to move economic activity from one state to another.

Thank you for the opportunity to present the Interim Report and these other matters to the Sub-Committee.

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ALBANY

RICHARD L. BRODSKY
Assemblyman 92ND District
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CHAIRMAN
Committee on
Corporations, Authorities
and Commissions

"THE HOUSE THAT YOU BUILT"

An Interim Report Into The Decision By New York City To Subsidize the New Yankee Stadium

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I. Introduction

The Committee on Corporations, Commissions and Authorities ("the Committee") has conducted a series of investigations into the activities of various State entities under its jurisdiction. This has included investigations of the Metropolitan Transportation Authority, the Thruway Authority, the Canal Corporation, the Long Island Power Authority, the Power Authority of the State of New York, the Hudson River Park Trust, the Empire State Development Corporation, Roosevelt Island Operating Corporation, local Development Agencies and Local Development Corporations, and others.

These investigations have uncovered a pattern of inappropriate and secretive lobbying by highly paid and politically connected procurement lobbyists, inappropriate hiring of politically connected former government officials, disposition of public property for less than its true value, interference with investigations of such behavior, failure to provide accurate and complete information to the public about authority activities and finances, and unfair and wrong decisions by authority personnel.

The Committee's investigations resulted in the first comprehensive statutory reform of public authorities, the Public Authorities Accountability Act of 2005. It enacted rules to eliminate conflict of interest in authorities, provide oversight and accountability over the process governing the sale of property by public authorities and created a statewide Inspector General to investigate waste, fraud and abuse.[6]

Although the Public Authorities Accountability Act created unprecedented oversight over authorities throughout the State, more needs to be done. The Committee has introduced legislation enacting further reforms in order to bring these massive bureaucracies back under control of democratic institutions; limit abuse and fraud; limit the issuance of public debt; and provide independent, outside oversight of authority actions.

As will be described in greater detail below, this Report sets forth facts surrounding the deal for the new Yankees Stadium, including but not limited to the economic and other incentives provided by New York City ("City") and the New York City Industrial Development Agency ("NYCIDA"). The Committee has jurisdiction over public authorities across New York and the City's use of the NYCIDA—itself a public authority—to drive the Stadium project raises serious questions as additional legislative reforms are advanced.

Working with the Committees on Local Governments, Cities, and Ways and Means, the Committee based this report on review of previously secret and undisclosed documents obtained by the Committee, sworn testimony taken at a public hearing, review of other public documents, meetings and discussions with City officials and other private and public parties; and numerous conversations with Federal, State, City and private persons. This is an Interim Report. As is its custom, the Committee will issue a Final Report after continuing its investigations and considering the views of interested parties.

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[6] Chapter 766 of the Laws of 2005.

II. Background and Chronology

A. The Announcement

In June 2005, shortly after the Mayor's proposal for a stadium on the Westside of Manhattan fell through, Mayor Bloomberg, Governor Pataki and other elected officials, and the New York Yankees announced an agreement to build a new stadium for the Yankees adjacent to the existing stadium.[7]

Two fundamental justifications were offered support of the subsidies included in the Yankee deal.

First, it was alleged that the financial assistance provided to the Yankees would create enormous economic benefit, largely by creating thousands of new jobs in the Bronx. Job creation was repeatedly described as an essential benefit to the public resulting from the public subsidies.

As Governor Pataki said in support of this claim:

> We're building a great new attraction in the Bronx and creating thousands of jobs, developing acres of new parkland and building a new multimodal transportation station that will improve the air quality and the overall environment for the area.[8]

Mayor Bloomberg agreed, stating:

> The new Yankee Stadium is an exciting public-private partnership that will revitalize the South Bronx with thousands of jobs...."[9] The City's press release claimed that "The project is expected to create nearly 6,500 construction jobs and result in about 1,000 permanent jobs.[10]

Empire State Development Chairman Charles Gargano also focused on job creation, saying:

> This smart investment will create thousands of temporary and permanent jobs and yield hundreds of millions of dollars in tax revenue in the coming years.[11]

The assertion that significant numbers of new permanent jobs would be created turned out to be inaccurate.

Second, the City has repeatedly asserted that the Yankees would themselves pay for the cost of construction, limiting the public subsidies to infrastructure, some direct funding, and the

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[7] Announcements were also made for agreements for new stadia for the Mets, and the soon-to-be Brooklyn.
[8] August 16, 2006 NYC press release: "Mayor Bloomberg, Governor Pataki and New York Yankees Break Ground on New $800 Million Stadium"
[9] August 16, 2006 NYC press release, Ibid.
[10] August 16, 2006 NYC press release, Ibid.
[11] January 18, 2006 ESDC press release: "Chairman Gargano Announces ESDC Board Approval for New Yankee and Shea Stadium's Infrastructure Plans."

tax-exempt financing provided by the City, State and Federal governments. NYCIDA President Seth Pinsky stated:

> ... the Yankees are paying entirely for that billion dollar stadium[12]...the entirety of the situation is that you have a private company that was willing to put a billion dollars into one of the poorest congressional districts in the country...[13]

According to a press release issued by the City:

> Funding for the $800 million in construction costs is being provided fully by the Yankees, who will also be responsible for operating and maintaining the new facility... The Yankees will be responsible for paying the entire cost of construction including any cost overruns. The City is contributing $160 million to replace parkland and make necessary infrastructure improvements, and the State is contributing $70 million for the construction of new parking facilities and $4.7 million to a capital reserve fund for the new stadium. In addition, last month the New York City Industrial Development Agency (NYCIDA) approved the issuance of about $920 million in tax-exempt bonds and $25 million in taxable bonds, both to be repaid by the Yankees. [14]

The claims that the Yankees are themselves paying for the Stadium were inaccurate.

B. The Deal

In the months that followed the details of the Stadium deal were negotiated and finalized. At the direction of the Mayor, the governmental efforts were spearheaded by the New York City Industrial Development Agency, an authority created by state legislation to promote economic activity and job creation.

Other active participants were Empire State Development Corporation (ESDC), the Mayor's Office, the Governor's Office, the National Park Service, the State Department of Parks, the New York City Office of Economic Development, the New York City Department of Finance (NYCDOF), the Internal Revenue Service (IRS), numerous lawyers retained by the parties, and others.

The final agreements created the following chain of ownership, authority, and benefit. The City would own the site of the new Yankee Stadium, and would lease it to the NYCIDA. The NYCIDA would directly own the Stadium itself. The NYCIDA would then lease both to a "special purpose, bankruptcy remote entity created as an affiliate of the Yankees,"[15] which would in turn lease it to the Yankees. The Yankees would not pay property taxes that they were otherwise legally obligated to pay. Instead the Yankees would

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[12] July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 65,
[13] July 2, 2008 public hearing. Ibid. Page 34.
[14] August 16, 2006 NYC press release: "Mayor Bloomberg, Governor Pataki and New York Yankees Break Ground on New $800 Million Stadium"
[15] February 1, 2006 Nixon Peabody letter to the IRS. Page 4.

pay to the NYCIDA a "PILOT" (Payment In Lieu Of Taxes) which would use these quasi-tax payments to pay off tax-exempt bonds[16] it would issue, originally said to be in the amount of $920 million[17], for a term of 30 years. In other words, the cost of the Stadium would be paid by diverting tax payments otherwise legally owed to the City. The City has admitted the Stadium is being paid for by taxpayers, saying: "The City has determined to use its property taxes (in this case PILOTs) to finance the construction and operation...of the Stadium."[18]

The total tax-exempt bonds awarded had an issue price of $966,168,577.50[19]. The annual interest savings[20] to the Yankees amounts to "approximately $7.7 million to $15.7 million"[21] for 30 years, totaling between $235 and $471 million.

It was also announced that there would be direct cash subsidies of around $235 million. The City and State, through ESDC, would also provide direct funding for infrastructure and other items in the amounts of $160 million from the City to replace parkland and make infrastructure improvements, and $70 million from the State for the construction of new parking facilities and $4.7 million from the State to a capital reserve fund.[22] The amount of the cash subsidies eventually paid were substantially higher, about $350 million. According to NYCIDA President Pinsky in July 2008:

> Current estimates for the city's portion of the project total about $280 million. This figure is admittedly higher than originally anticipated[23]...the state has committed to invest approximately $75 million...[24]

When the cash subsidy of about $350 million is added to interest savings of between $235 and $471 million, the total cost to taxpayers and savings to the Yankees is between $585 million and $826 million.

The plan for tax-exempt financing by the NYCIDA immediately raised two difficult legal questions. First, did the Yankee Stadium project meet the legal standards for NYCIDA approval; and second, did the Yankee Stadium Project meet the legal standards for IRS approval? In a short period of time both the NYCIDA and the IRS answered both questions affirmatively, allowing the project to move forward. The correctness of those answers is discussed below on pages 7 through 22. The State also enacted legislation to permit the taking of existing parkland for the non-park purpose of building the Stadium,

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[16] The NYCIDA decision to use the PILOT as security for tax-exempt bonds raises significant legal and policy questions which are discussed below on pages 25 and 26.
[17] August 16, 2006 NYC press release: "Mayor Bloomberg, Governor Pataki and New York Yankees Break Ground on New $800 Million Stadium"
[18] February 1, 2006 letter to IRS from Mitchell Rapaport and Bruce Serchuk (Nixon Peabody LLP). "NYCIDA – Request for Private Letter Ruling under section 141 of the Internal Revenue Code." Page 47.
[19] Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of The IRS Code of 1986. Exhibit A. Initial Issue Price Certificate.
[20] The interest savings are a combination of state, federal and local tax exemptions.
[21] July 31, 2008 letter from Robert LaPalme to Chairman Brodsky. Page 2.
[22] August 16, 2006 NYC press release. Ibid.
[23] July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 14.
[24] July 2, 2008 public hearing. Ibid. Page 13.

requiring that replacement parkland of equal fair market value be added to the Bronx parkland system. A Community Benefits Agreement[25] was signed setting forth various benefits to communities in the Bronx that would attend the construction and operation of the Stadium.

On the basis of these actions the NYCIDA sold the bonds in August 2006, the other subsidies were provided, and construction of the new Stadium was commenced.

Early in 2008 the Yankees indicated that they would seek additional tax-exempt funding in the amount of $366.9[26] million for "completion" of the stadium projects. A preliminary application was filed with the NYCIDA. Action on the application has not taken place pending efforts by the Yankees, the NYCIDA, and others to reverse a proposed IRS regulation, which apparently makes the new bonding difficult or impossible. An analysis of the additional request is found below on pages 24 and 25.

III. The Committee's Inquiry

The use of public subsidies to build sports facilities is widely controversial. There has been deep interest in whether the public would benefit from the billions of dollars in financial assistance to the Yankees, an enormously successful and wealthy private entity, and whether the process used to advance these projects was transparent, truthful, and responsible. For these reasons, the Committees on Corporations, Commissions and Authorities; Local Governments; Cities; and Ways and Means began an inquiry into these matters. A public hearing was held, documents were requested and provided[27], meetings and discussions with City officials took place, and an analysis was begun. Parallel to these activities, a Congressional investigation was begun, which will include a public hearing on September 18. The Committees' work is not completed. This Interim Report is being issued to disclose what has been learned so far, and to focus our continuing work on the remaining unanswered questions.

A. The Committee's Concerns

The Committee began its' inquiry with three basic questions.

- **First, should there be measurable benefits to the public when government financial assistance is provided to a private entity?**

As taxpayer support for private corporations and private economic activity has mushroomed in recent years, the fundamental question of public benefit has surfaced and resurfaced, without a consistent and satisfying answer. Critics on both the left and right have decried these taxpayer subsidies as socialism, wasteful, corrupt, anti-free enterprise, and unfair to

[25] The implementation of the Community Benefit Agreement has been the subject of controversy. The Committee is continuing to inquire into these issues.
[26] Yankees Core Application. Annex 2-6, "Completion Bond Sources and Uses Table."
[27] The NYCIDA produced voluminous documents with unfailing courtesy. It is unclear if all requested information was produced however. The DOF produced some documents. It is likely that all information requested has not been produced. The Committee is pursuing those documents.

average citizens whose economic struggles are undertaken without public subsidy. Yet the phrases "economic development", "job creation", "growth" etc., retain enormous political power. A real analysis of these subsidies has yet to be done, but there clearly is growing pressure to insure that public benefits flow from public investments. It is clear, however, that everyone from the most ardent supporter to the most ardent critic of the deal agrees that public subsidies are a decision to employ taxpayer money for the benefit of the public. Without a measurable, identifiable, specific and significant public benefit, public financial assistance should not be given. For better or worse then, the Committee answers the first question with a resounding "yes", because common sense, the law and growing political and public concern about ineffective and unfair subsidies require that public dollars be spent only when there is a clear and provable public benefit.

- **Second, what public benefits, if any, resulted from the substantial financial assistance provided to the Yankees?**

The Committee has been unable to identify significant public economic benefits from the investment of between $500 million and $1 billion of public money. New York City and State have innumerable programs, which distribute billions in subsidies to private persons annually, with little or no proof of effectiveness or public benefit. Even at their worst, however, all these programs have maintained a legal requirement that there be a measurable public benefit, and the Yankee Stadium transactions were no different. What evidence exists shows that few of the assertions of public benefit were accurate, that there is in fact little in new job creation, private investment, or new economic activity, while there is enormous private benefit. Most importantly, the legal requirements of proof of such public benefits have been manipulated. The repeated initial assertions of job creation and reliance on Yankee resources to pay for the Stadium were initially widely accepted. The evidence uncovered by the Committee has cast substantial doubt on their accuracy.

- **Third, was the process used to explain, examine, and approve the Stadium deal transparent and honest?**

The actions of various state, city, and private parties contained a series of promises and claims that were aimed at both public opinion and the requirements of law. Little or no scrutiny of these actions took place while they were being negotiated and approved. While there were a series of formal hearings and the Yankees and the NYCIDA place much reliance on them[28], few of the details of the deal were publicly known and many were buried in the thousand of pages of legal and bureaucratic submissions made to various public agencies. The degree to which the promises, assertions and legal obligations of parties to the deal have been candidly and honestly carried out is a grave concern for the Committee, is the subject of continuing investigation, and is discussed at length below.

[28] July 2, 2008 letter from Randy Levine (Yankee President) to Chairman Brodsky and July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 22: Pinsky: "...Some had recently claimed that this process occurred behind closed doors. This is simply wrong. In fact, the public was given the opportunity to offer input at approximately 20 hearings with review provided by government officials at the city, state, and federal levels."

B. Additional Questions of Transparency and Honesty

As a result of information uncovered in the initial inquiry additional questions of transparency, honesty, and economic benefit have been raised, which are also discussed below. These include: the actions of the NYCIDA, the IRS issues, the City purchase of a luxury suite, the use of PILOTs to create debt, the request for additional financing, the role of elected officials, and the price of tickets at the new Stadium.

IV. The Actions of the NYCIDA

A. Powers and Duties of the NYCIDA

By deciding to use the NYCIDA as the primary vehicle for the deal, the Mayor empowered a relatively obscure agency to make major policy decisions, and to structure a deal involving billions of dollars and numerous public and private parties. The NYCIDA was the party with the legal authority and legal responsibility to represent the public interest. The powers and purposes of the NYCIDA are set forth in state law, and include:

> To promote, develop, encourage and assist...industrial, manufacturing, warehousing, commercial, research and recreation facilities...and thereby advance the job opportunities, health, general prosperity and economic welfare of the people of the state of New York and to improve their recreation opportunities, prosperity and standard of living..."[29]

The NYCIDA is required by law to have a specific policy for the granting of public assistance that describes the public benefit that will result. This is the "Uniform Tax Exemption Policy" (UTEP).[30] It is the UTEP which creates the standards that distinguish between projects that have a public benefit and should be subsidized and those that do not.

According to the UTEP, in making the decision to provide financial assistance the NYCIDA Board must consider: "the extent to which a proposed Project will create or retain permanent, private-sector jobs," "whether Financial Assistance is required to induce the Project," "whether the Project involves an industry or activity which the City seeks to retain and foster," "the estimated value of any other benefits that the City may be providing," and "the amount of private-sector investment to be generated by the proposed Project," among other factors.[31]

The UTEP also states that in order to qualify for financial assistance, it must be proven that without it, "...the Project would most likely not be taken by the proposed Recipient; or, if

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[29] Article 18-A of the New York State General Municipal Law.
[30] The UTEP is required by Section 874 of New York State General Municipal Law: "The agency shall establish a uniform tax exemption policy...which shall be applicable to the provision of financial assistance..."
[31] Second Amended and Restated UTEP of the NYCIDA. Page 1.

undertaken at all by such Recipient, the Project might occur at a substantially reduced level or outside of the State."[32]

Also according to the UTEP in order to qualify for funding, it has to be shown that without this financial assistance "...(i) a Recipient would either not retain and/or attract a specified number of employees or a business function or unit for a specified period of time within the City, and/or (ii) the loss of a vital service to the City might occur..."[33]

The City determined early in the process that the Yankee deal could not meet these requirements. The NYCIDA explicitly admitted this, saying "...the terms of the provision of financial assistance for the proposed project do not conform to the provisions of UTEP."[34]

Some of the facts which led to this conclusion are:

1.)The deal did would not create the new permanent jobs that had been widely promised, and would not meet other elements of the UTEP. The application the Yankees filed with the NYCIDA disclosed that only 15 permanent new jobs were to be created, and only 71 part-time jobs.[35]

2.) The stadium was a "retail" project of a kind disfavored by the NYCIDA law.

3.) There was little of new permanent economic benefit to the host communities in the Bronx. The percentage of Yankee employees actually residing in New York City, and therefore the amount of economic benefit to New York City residents, is relatively low. Only about 50% of full time Yankee employees were New York City residents at the time, and only approximately 20% of part time employees.[36]

4.) Given that the deal was funded by deferring tax payments otherwise legally owed by the Yankees, there was relatively little private investment by the Yankees in the project.

These facts were well known and publicly discussed at the time. The New York City Independent Budget Office (IBO) in testimony before the New York City Council on April 10, 2006 said, "...there is little reason to expect much gain in local economic activity beyond the three year construction period. The Yankees will generate additional revenues as a result of the higher average ticket and concession prices at the new stadium, but because a large share of sports business income flows to a relatively small number of players, and owners - few of whom reside in the city – much of these earnings will be spent elsewhere."[37]

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[32] Second Amended and Restated UTEP of the NYCIDA. Page 2.
[33] Ibid. Page 2.
[34] NYCIDA "Deviation from Uniform Tax Exemption Policy for Yankees Ballpark Company." Page 1.
[35] Yankees Core Application to the NYCEDC, page 7. There was substantial temporary economic activity surrounding construction of the Stadium, with several thousand temporary construction jobs (Such temporary activity is usually a factor only when it can be ascertained that if the subsidy is not provided the work will not be done.)
[36] Yankees Core Application to the NYCEDC, page 7.
[37] NYC IBO testimony before the City Council Finance Committee on Financing Plans for the New Yankee Stadium. April 10, 2006. Page 4.

There were a considerable number of temporary jobs, created largely in construction.[38] These are a measurable economic benefit. However, the law and common sense do not rely on these jobs to justify a public subsidy. If they did, any large project employing large numbers of construction workers would receive taxpayer assistance, even if no other public benefit resulted.

B. The "Deviation Letter"

Having decided to ignore UTEP standards, the NYCIDA used what can charitably be called a loophole in the law. The loophole says that the NYCIDA can provide financial assistance to an otherwise ineligible project by "deviating" from the UTEP benefit standards, and prescribes a procedure for such "deviation". The NYCIDA then sent a "deviation letter" to Mayor Bloomberg indicating that the project did not meet the UTEP standards, but would be funded anyway. The Deviation Letter states: "The project would not be eligible for the necessary financial assistance without the deviation from the UTEP." [39]

The NYCIDA is required to give a reason for the deviation and for the decision to provide the benefits in spite of the failure to meet the UTEP standards.

C. The Yankee Threat to Leave New York City

The sole reason given in the Deviation Letter was that the Yankees had threatened to, and actually might, move out of state. "Failure of the Stadium project...would likely result in the New York Yankees relocating the Team to a stadium outside the City."[40] It also notes that "Ballpark company and the Yankees have indicated to the NYCIDA that the benefits outlined above are critical to the financing of the Project and that the Project would not proceed as planned without access to NYCIDA benefits." [41]

Also, in a sworn statement to the IRS, the NYCIDA explicitly set forth the threat of the Yankees leaving the State as the reason to enter into a PILOT agreement. PILOTs are a "...reduction from the amount of real property taxes that would have been imposed that the NYCIDA believed was necessary to induce the Team to remain in the City."[42]

The threat to relocate from the City was the sole reason cited for the decision to give the Yankees financial assistance and was constantly repeated publicly and in legal documents.

NYCIDA President Seth Pinsky said:

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[38] According to the 2006 Environmental Impact Statement for the Stadium Project, construction job estimates totaled 3,600 construction jobs related to Stadium construction. August 5, 2006 letter from Robert LaPalme (NYCEDC) to Chairman Brodsky. Memo on "Yankee Stadium Area Project Empoyment."

[39] NYCIDA "Deviation from Uniform Tax Exemption Policy for Yankees Ballpark Company." Page 1. The letter is undated but was likely sent prior to the Inducement Resolution of March, 17, 2007.

[40] NYCIDA "Deviation from Uniform Tax Exemption Policy for Yankees Ballpark Company." Page 5.

[41] NYCIDA "Deviation from Uniform Tax Exemption Policy for Yankees Ballpark Company." Page 4.

[42] July 19, 2006 Private Letter Ruling for Yankee Stadium PILOT Bonds. Page 4.

> ...the only option for keeping them in the Bronx was a new stadium.[43]

The Committee has found no evidence that this crucial threat was ever made in these negotiations, the Yankees have been conspicuously silent on the subject, and the NYCIDA itself later backed off this claim:

> Chairman Brodsky: Who in the NYCIDA was told by the Yankees that they would leave?
> Mr. Pinsky: I don't recall.
> Chairman Brodsky: Was anybody in the NYCIDA told?
> Mr. Pinsky: There may have been. I don't recall.[44]

In response to the Chairman's question of "Can you tell us in what form the Yankees threatened to leave New York?", Mr. Pinsky responded with:

> The Yankees have made a number of statements over the years that they would be interested in leaving the South Bronx if they didn't have a more modern stadium.[45]

Because of the public and legal importance of the threat to leave, because it was the sole reason given in defense of the subsidies, because of the uncertainty about whether the threat to relocate was actually made, and because of the vacillating NYCIDA statements, the Committee sought evidence about who made this threat and when it occurred.

The Committee requested documentation from the NYCIDA confirming its allegation that the Yankees would relocate without public assistance.[46] The only response from the NYCIDA to those requests was a packet of news clippings, largely containing speculation by reporters on the Yankees threatening to leave New York City, dating back to 1993.[47]

These press clippings provide no evidence that, at the time of the NYCIDA negotiations, the Yankees had threatened to leave. There is nothing in the public record which backs up the public and legal assertions that the Yankees threatened to leave, no evidence of efforts by the NYCIDA to assess the actual threat, and no evidence that the Yankees had a financially and politically practical relocation site outside of the City. There is no evidentiary basis for the NYCIDA's assertion that relocation of the Yankees was a real issue in these discussions.

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[43] Page 52, July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City.
[44] Page 51, July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City.
[45] July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 50.
[46] July 11, 2008 letter from Assemblyman Richard Brodsky to NYC EDC President Seth Pinsky.
[47] In once such quote Metro reports Yankees' attorney Jonathan Schiller's statement with respect to litigation occurring well after the project had been approved that "'The Yankees will have to consider leaving the city." Arden, Patrick. "Yanks Threaten to Walk if Court Rules Against Ballpark." Metro. August 11, 2006.

At the suggestion of the NYCIDA[48], the Yankees have been directly asked about any threats to relocate they may have made. They have failed to answer these questions.[49]

The best that can be said about the Deviation Letter is that it is mere speculation. It may also be misleading. In any event, the decision to commit billions in financial assistance required more effort, more inquiry and more evidence of a public benefit than was provided by the NYCIDA.

D. The "Inducement Resolution"

The actual approval of the tax-exempt financing by the NYCIDA board took place on March 17, 2006 in the form of a customary and legally required "Inducement Resolution". That resolution, signed by Mayor Bloomberg and Yankee President Randy Levine, is required, among other things, to recite the reasons for the tax-exempt financing.

Normally, this would include the UTEP findings of a public benefit. However, since a Deviation Letter was used in place of a UTEP finding, and since the sole reason given in the Deviation Letter was the Yankee threat to relocate, the Inducement Resolution should have included that threat.

It does not. The reason given in the Inducement Resolution is that the Stadium project "will serve the Agency's public purposes...by preserving or increasing the number of permanent, private sector jobs in the City and State of New York"[50], contradicting the analysis of job creation by the NYCIDA when it decided to "deviate" from the UTEP. The Yankee NYCIDA application states that only 15 new permanent jobs would be created. It can be fairly concluded that in the eyes of the Mayor, the Yankees, and the NYCIDA, 15 new permanent jobs constitute "increasing the number of permanent, private sector jobs,"[51] at a level justifying hundreds of millions of dollars in taxpayer subsidy. That is neither fair nor reasonable.

The Inducement Resolution also notes that the stadium is a "retail" project,[52] which would not normally qualify for NYCIDA funding, but that it in fact is eligible because it is "located in a highly distressed area."[53] The Yankee employees do not seem to live in significant numbers in the community surrounding the Stadium, or in the City, or State. Whatever its physical location, Yankee Stadium has not been a major economic force in the lives of neighborhood residents.

The legal consequences of the inconsistent legal justifications are the subject of continuing Committee inquiry. It is unclear whether an Inducement Resolution can ignore the statutory

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[48] July 2 public hearing, Ibid. Page 52: Pinsky: "...you can ask the Yankees this question too..."
[49] The Committee has been verbally informed that the Yankees intend to answer these questions at an unspecified later date.
[50] Tax Certificate Ibid. Exhibit F. Page 2, Section 2.d
[51] Tax Certificate Ibid. Exhibit F. Page 2, Section 2.d
[52] Tax Certificate Ibid. Exhibit F. Page 2, Section 2.a
[53] Tax Certificate Ibid. Exhibit F. Page 2, Section 2.b

requirement of the UTEP and Deviation Letter. It is also unclear whether NYCIDA counsel or Bond Counsel discussed or offered opinion on this matter.[54]

V. The IRS Issues

A. The Private Ruling Letter

The NYCIDA approval of tax-exempt financing did not overcome a considerable additional obstacle in Federal law. The IRS had become increasingly reluctant to continue to approve tax exempt financing for sports facilities. There had been a growing, nationwide consensus that such subsidies did not produce commensurate public benefits, and that the reduction in revenues to the Federal, state and local governments was not in the public interest.

> "Doug Turetsky, spokesman for the city's Independent Budget Office, said stadiums typically don't have a significant financial impact on the communities in which they are located. That's especially true, he said, when teams relocate to a new stadium that has fewer seats and higher ticket prices. ....[Neil DeMause, co-author of "Field of Schemes: How the Great Stadium Swindle Turns Public Money into Private Profit"] testified last year before a congressional committee about the financing of stadiums with tax-free borrowing. He said then that research shows stadiums have 'no measurable impact on per-capita income' and do not revitalize urban neighborhoods that surround them." [55]

> "Publicly funded stadiums "have no effect on the growth rate of real per capita income and may reduce the level of real per capita income in cities that build them," [economist Brad] Humphreys [a stadium-finance expert at the University of Alberta] wrote with Dennis Coates in the most readable survey of the arcane field of stadium finance in Regulation magazine back in 2000. The reason, as the 26 economists write this week, "appears to be that sports stadiums do not increase overall entertainment spending but merely shift it from other entertainment venues to the stadium."[56]

For years, the IRS had deferred to state and local governments to determine if there was sufficient public benefit to justify tax-exempt financing for special projects. The IRS makes no independent assessment of the worthiness of such projects, probably on the assumption that no state or local government could or would seek tax-exempt funding for the benefit of a private party.[57]

The IRS did require such projects to pass highly technical legal tests, the "Private Business Use" test and the "Private Security or Payment" test. These were intended to identify

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[54] Questions about the role of the Bond Counsel and other counsel are discussed on pages 13 and 14.
[55] Herbert, Keith and Michael Frazier. "Do Public Subsidies Pay Off?" Newsday. July 2, 2008.
[56] Washington Times Editorial. "No Point in a Subsidy." June 11, 2008.
[57] Most State Constitutions do not allow for gifts of loans for the benefit of private parties. A few examples are as follows: Pennsylvania State Constitution, Article VIII, Section 8; Washington State Constitution, Article VIII, Section 5, Arizona State Constitution, Article IX, Section 7; North Carolina State Constitution, Article V, Section 3.

transactions that benefited private parties and these became the focus of the IRS controversy, in a detailed, lengthy and often contentious exchange of letters.

The City addressed IRS concerns by first admitting that there was a private benefit in the Yankee transaction, saying that "...the transaction results in private business use of the proceeds of the Tax Exempt Bonds."[58] The IRS acknowledged this as well, stating that "...all of the Stadium is reasonably expected to be used for a Private Business Use."[59]

However, the City argued that as long as the PILOT payments were not in excess of the real property taxes otherwise owed by the Yankees, the tests were met and the IRS should approve the tax exemption for the bonds. In other words, the IRS should not object to the use of PILOTs to pay off tax-exempt bonds floated to build the Stadium, if the PILOT payments were not artificially inflated to meet the debt service requirements. Again, if $50 million was needed annually to pay off the bondholders, but actual property taxes or PILOT payments generated only $30 million, the local government could not artificially raise the tax or PILOT payment the additional $20 million a year, even with the permission of the taxpayer.

That the PILOTs would be enough to pay the debt service on the bonds was a logical consequence of DOF assessment policy according to proponents of the deal: "...the fact that the PILOT comes close to actual taxes is not a coincidence. Even though negotiated, use of the same assessment methodology should make the PILOT 'commensurate' with NYC real property taxes."[60]

If DOF, however, had artificially inflated the assessed value, the entire legal justification for the tax-exemption collapses and the tax exemption would be denied. It is noteworthy that this concern was publicly discussed. The New York City IBO specifically raised the issue in testimony by the New York City Council: "Given the large annual payments needed to service...tax exempt bonds...a regular property tax bill would be...considerably below the annual debt service payments."[61]

This warning was ignored by the City, the IRS, the Yankees, and the lawyers for all parties.

There is a significant question as to whether the IBO statement should have triggered additional due diligence by public officials and Bond Counsel on the issues of stadium and land assessments and the adequacy of the PILOT revenue stream. The role of Bond Counsel in this and other matters is an unresolved issue. Attempts to clarify these issues

[58] February 1, 2006 letter from Mitchell Rapaport and Bruce Serchuk (IRS) to the IRS. Page 47.
[59] Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of The IRS Code of 1986. Page 15, Section d.2
[60] E-mail from Steven Lefkowitz (Fried Fank) dated July 2, 2006. Included in Robert LaPalme (NYCEDC) submission to Chairman Brodsky of August 5. 2008.
[61] NYC IBO testimony before the City Council Finance Committee on Financing Plans for the New Yankee Stadium. April 10, 2006. Page 4.

with certain Bond Counsel were unsuccessful on the asserted basis that ethical constraints forbade any discussion with the Committee.[62]

The heart of the IRS policy is to stop manipulation of property taxes for the purpose of receiving tax exempt financing. In other words, if the Yankees were treated as any ordinary taxpayer would be treated, the bonds could be approved. There was intense and voluminous correspondence between the IRS and the NYCIDA, Yankees, and others largely responding to IRS concerns. The NYCIDA swore to the IRS that the Yankees would be so treated[63] and that the annual PILOT would be "commensurate"[64] with the actual property tax liability of the Yankees to New York City, and, in a key assurance by the NYCIDA, that the New York City Department of Finance, which sets the assessed value for each parcel in the City, would assess the property in accordance with normal and accepted procedures.

In a July 3, 2006 letter to the IRS, NYCIDA counsel asserted that "...the New York City Department of Finance ("Finance"), the City agency that is responsible for assessing any property located in the City subject to real property tax, will use the same assessment method for the Stadium is *(sic)* used for assessing properties of the same class within the City...In other words, the City's use of the actual assessed value, equalization rate, and tax rates...results in that PILOT being commensurate with the applicable real property tax."[65] The NYCIDA was legally obligated to make sure that the Yankee Stadium property was assessed as every other such property is assessed, and to apply the same tax rate applied to any other such property, and to not artificially inflate the tax payments. It did not keep that commitment, the DOF assessment was inflated, and the IRS was never informed.

On the basis of these assurances the IRS issued a "Private Letter Ruling" approving the Stadium project for tax exempt financing. The IRS made explicit its reliance on NYCIDA representations, saying, "the PLR [Private Letter Ruling] is based on the facts and representations as provided to the Internal Revenue Service by the Agency and as set forth in the PLR itself and that deviations from such facts and representations could cause the PLR to be inapplicable to the Bonds."[66] It added, "The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party."[67]

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[62] Peter White, counsel widely crediting with structuring the deal, declined by letter to speak with the Committee. September 3, 2008 letter from Robert Bernius (Nixon Peabody LLP) to Chairman Brodsky and September 15, 2008 letter from Chairman Brodsky to Peter White.

[63] Chairman Brodsky: Was the material provided to the NYCIDA certified, sworn, or in any way verified?
Mr. Pinsky: Yes.
July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 128.

[64] July 3, 2006 letter from Mitchell Rapaport and Bruce Serchuk (IRS) to Rebecca Harrigal (IRS). Page 2.

[65] July 3, 2006 letter from Mitchell Rapaport and Bruce Serchuk (Nixon Peabody LLP) to Rebecca Harrigal (IRS). Page 2

[66] Tax Certificate Ibid. Page 14, Section d.1

[67] Tax Certificate Ibid. Exhibit F. Page 12.

B. The DOF Assessment of Yankee Stadium

The DOF then began the promised assessment process.

The NYCIDA and the Yankees were caught in a bind. On the one hand they had sworn that the assessment would not be inflated and that Yankees Stadium would be assessed as would any other property. On the other there was a real question as to whether the assessed value of the new Yankee Stadium would be high enough to generate PILOTs sufficient to pay the debt service on the bonds.

The Department of Finance began assessing the Stadium property in early 2005 using the "cost" method of assessment, rather than any income or revenue based method.

The assessed value was the total of the assessed value of the land upon which the Stadium sat, and the assessed value of the new Stadium itself.

1.) The Assessed Value of the Land Beneath the Stadium

The DOF began with its own assessment of the land beneath the new Stadium, 14.5 acres of park land. It has been parkland for years, and required special state legislation to permit its use for a non-park purpose.[68] The legislation does not remove the designation as parkland, it permits a non-park use of the land, i.e. the building of the new Stadium. It remains parkland, and any other non-park uses would require additional legislation.

It is accepted valuation practice for the DOF to measure land value by determining the value of "comparable" parcels of land. Those "comparables" are then adjusted for a series of factors, including time (real property, until recently, has increased in value over time, so a sale price of two years ago is adjusted to reflect two years of price inflation), size (large parcels are much less common and more difficult to use, so smaller parcels tend to sell for more per square foot than large ones, requiring a size adjustment if small parcels are used to value a large one), and location (it is best practice to find "comparables" in the same geographic and political neighborhoods. If no "comparables" exist locally, then parcels far away can be used, but a location adjustment is made.)

The Committee's investigation has found significant failures on the DOF assessment, in the areas of the location of comparable parcels, acreage, a second appraisal, and the assessed value of neighboring land.

a. Location of Comparable Parcels

It is customary and best practice to use comparable parcels in the same community as the land being assessed. Instead, DOF chose to use eight "comparable" parcels from Manhattan, and none in the Bronx. No explanation of the decision to ignore Bronx parcels has been offered by DOF. The stated reason to choose Manhattan parcels was that the Harlem area and the Stadium section of the Bronx were undergoing similar redevelopment.[69]

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[68] Chapter 238 of the New York State Laws of 2005.
[69] July 24, 2008 NYCDOF meeting with Chairman Brodsky.

It is undisputed that real estate values in Manhattan are significantly higher than those in the Bronx.

The decision to ignore Bronx land values has not been explained or justified. There are comparable parcels in the Bronx, there is no evidence of similarity of value between Harlem and the Bronx, and most disturbingly, despite written assurance, DOF used parcels in Manhattan which are not located in Harlem.[70] Parcels in Chelsea and the Lower East Side are included in the list of comparable parcels, again with no explanation.

The cumulative effect of these decisions is to substantially inflate the assessed value of the Stadium land.[71]

b. Adjustments

The DOF did not make the customary adjustments for location, size and time.[72] DOF did make an adjustment for time, which increased the value of the land. It did not make an adjustment for size, which would have decreased the value. It did not make an adjustment for location, which would have decreased the value. DOF, in violation of its own standard practices, made only those adjustments which increased value and failed to make the adjustments which would have decreased value. When asked, DOF had no explanation for this decision.[73] The effect of these decisions was to substantially inflate the assessed value of the Stadium land.

c. Acreage

Although the Stadium parcel is actually 14.5 acres, DOF calculated the value of the parcel as though it were 17 acres. There has been no explanation of why this happened, DOF, a year later, changed the acreage to 14.5 acres, and recalculated and reduced the value of the land a year later, although it did not inform the IRS of this change.

There were also a complicated set of redrawings of the boundaries of the Stadium parcel that are difficult to understand, and may or may not be related to the use of the erroneous acreage. It appears that both the Yankees and DOF were part of the process by which the lots were redrawn and the acreage calculated. The effect of these decisions was to inflate the assessed value of the Stadium deal.

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[70] April 10, 2006 letter from Dara Ottley-Brown (NYCDOF) to Gregory Carey (Goldman, Sachs & Co.). Page 2.

[71] July 24, 2008 NYCDOF meeting with Chairman Brodsky.

[72] This failure to make these adjustments was confirmed by DOF staff at a meeting with Chairman Brodsky on July 24, 2008.

[73] July 24, 2008 NYCDOF meeting with Chairman Brodsky.

d. The DOF Assessed Value of the Land

As a result of these decisions the DOF determined the value of the Stadium land to be $204 million, $275 a square foot, $12 million an acre.[74] This value was transmitted by letter to the NYCIDA on April 10, 2006.[75]

e. The Second and Third Parkland Appraisals

The City did two other appraisals of the Stadium land, both of which dramatically contradict the DOF assessment, and both of which were withheld from the IRS, state and Federal officials, and the public.

1i. The Parkland Appraisal

State and federal laws required an appraisal of the Stadium land, because of its status as parkland and the need to replace the lost parkland with land of equal value.

The appraisal requirement was set forth in Chapter 238 of 2005, the State law which allowed parkland to be used for the new Stadium, as well as by federal law. The purpose of this appraisal was to assure that the replacement parkland added to the Bronx park system would be at least equal in value to the parkland lost to the new Stadium. This is the policy of the Legislature when it is asked to change the status of parkland, and well as a Federal requirement.

Chapter 238 sets forth the specific requirements:

"§ 3. ... the city of New York [shall] acquire additional parklands...of equal or greater fair market value in the Borough of the Bronx....

"§ 7. ... the city of New York [shall] assure that the substitution of other lands shall be equivalent in fair market value and recreational usefulness to the lands being alienated or converted."[76]

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[74] The later reduction of acreage reduced the total land value to $175 million: July 24, 2008 NYC DOF meeting with Chairman Brodsky.

[75] April 10, 2006 letter from Dara Ottley-Brown (Assistant Commissioner, NYCDOF) to Gregory Carey (Goldman Sachs).

[76] § 3. The authorization provided in section two of this act shall be subject to the requirement that the city of New York dedicate the site of the existing Yankee Stadium to park use, and acquire additional park lands and/or dedicate land that is currently inaccessible by the public for park or recreational purposes, of equal or greater fair market value in the Borough of the Bronx and/or perform capital improvements to park and recreational facilities in the Borough of the Bronx which are equal to or greater than the fair market value of those park lands being alienated by this act.
§ 7. The conveyance of parkland authorized by the provisions of this act shall not occur until the city of New York has complied with any federal requirements pertaining to the alienation or conversion of park lands, including satisfying the secretary of the interior that the conversion complies with all conditions which the secretary of the interior deems necessary to assure that the substitution of other lands shall be equivalent in fair market value and recreational usefulness to the lands being alienated or converted.

The IRS similarly required "the substitution of other recreational properties of at least equal fair market value and of reasonably equivalent usefulness and location."[77]

If the DOF appraisal had been used, it would have required an addition of $204 million in new parkland. Rather than send the National Park Service and the State Department of Parks the DOF appraisal, the City, acting through NYC Citywide Administrative Services did another appraisal by hiring a known outside appraiser.[78] That appraisal, relying on parcels in the Bronx, valued the same property that DOF had valued at $204 million at $21 million, $45 per square foot, $1.5 million per acre.[79] The second appraisal was submitted to the NPS and the State Department of Parks. The existence of the DOF appraisal was not disclosed to Park officials.[80]

Whether or not this constitutes a violation of federal and state law is a matter of continuing interest to the Committee.[81]

2i. The Grubb & Ellis Appraisal

Pursuant to the requirements of the Public Authorities Accountability Act of 2005, the City, through the New York City Economic Development Corporation, contracted with Grubb & Ellis, a well-known real estate appraiser, to value the land under Yankee Stadium. It is clear from a series of e-mail messages involving numerous City officials, private attorneys, the Yankees and others that the purpose, terms, and results of this appraisal were widely known, even as it affected discussions with the IRS.

The methodology of this appraisal differed from the DOF appraisal in that it did not use a "cost" method, it used an "income capitalization" method. The reasons for this change, and the varying elements of the appraisal discussed in the e-mails are not yet clear. The appraisal valued the land at $40 million.

The existence of this third appraisal was also withheld from the IRS, the DOF, federal and state parks officials and the public. It is not clear if the appraiser was given copies of the DOF or parkland appraisals.

It can reasonably be concluded that given the wide discussion and dissemination of this appraisal, City officials in and out of the Mayor's Office were aware of the discrepancy between this and the other appraisals, and that the apparent failure to justify the profound differences among the three appraisals was not an accident or omission.

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[77] Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of The IRS Code of 1986. Exhibit F. A-3.
[78] "Self-Contained Appraisal Report, Land Beneath Yankee Stadium." May 3, 2006.
[79] "Self-Contained Appraisal Report, Land Beneath Yankee Stadium." Cover letter. May 9, 2006.
[80] It should be noted that the State legislation setting forth these requirements also pertains to the land used for Yankee Stadium parking garages.
[81] The Commissioner of the Department of Parks has been notified of these actions: September 8, 2008 phone call to Carol Ash, Commissioner, from Chairman Brodsky.

f. Land Value of Neighboring Parcels

In order to gauge the reasonableness of the DOF value of $275 per square foot for the Yankee Stadium land, the Committee reviewed the assessed values of land surrounding the new Stadium site. This review reveals that DOF has assigned values to these parcels that are a tiny fraction of the value assigned to the Yankee Stadium land, even those parcels that do not suffer from the "parkland" restriction that limits the use and value of the Yankee Stadium land.

The apartments on the corner of 162nd street are on a parcel valued at $14 per square foot, and the supermarket at 881 Gerard Avenue is on a parcel valued at $38 per square foot, and the parcel on which the McDonalds on 161st Street is located is valued at $63 per square foot;. The average value of the land parcels encompassing the strip across from the current Yankee Stadium is $36 per square foot. Of particular note is the value of the land currently being developed by Related Companies into the Gateway Center at the Bronx Terminal Market, a "retail" shopping plaza which includes stores such as Target and Bed, Bath and Beyond; the average assessed value of this land is $9 per square foot. This parcel would seem to be closest in purpose, investment, and community impact to the Yankee Stadium site. Yet the land, according to DOF, is worth about 3% of the value of the Stadium land. There has been no explanation of these discrepancies, or the DOF policies and practices that create them. A more detailed list of neighboring property values is attached in Appendix A.

g. Summary of Land Value Findings

The City, the NYCIDA and the DOF, in valuing the Yankee Stadium land at $204 million, and submitting that value to the IRS, used parcels in Manhattan and not in the Bronx, misrepresented the location of those parcels within Manhattan, did not adjust down for location and size while adjusting up for time, based its valuation on a 17 acre parcel while the actual acreage was 14.5 acres, ignored land values for neighboring parcels that are a fraction of the value assigned to the Stadium parcel, and simultaneously submitted to the Federal and State governments an appraisal of the same land at about 10% of the DOF valuation. These repeated and undisputed actions are evidence that the Yankee Stadium land valuation was significantly inflated, in spite of accepted professional assessment practices, and the promise to the IRS that the Yankees would be treated as would any other taxpayer.

The evidence shows that the assessment was manipulated, that different agencies of the Federal government were given dramatically different values that in each case protected an economic interest of the City, that responsible officials were aware or should have been aware of these failures, and that the state and the IRS, which relied on the NYCIDA's assertion that the Yankees would be treated like any other taxpayer, have an interest in determining the actual value of the underlying land and whether the assurances given were actually carried out.

2. The Assessed Value of Yankee Stadium

In addition to its' assessment of the Stadium land, the DOF began a valuation of the Stadium itself. DOF used the replacement cost method of valuation, arguing that for a sports facility the cost to replace the facility was a better method than the income

capitalization method. That is, rather than try to establish the sale price and assessed value for an asset that almost never reaches the market by capitalizing its income stream, DOF would determine the cost of building the facility itself.[82] However, after describing its assessment of Stadium land as "independent," DOF inexplicably stated that it would accept cost numbers for the Stadium itself as provided in "the schedule of construction costs provided by Goldman, Sachs and Co"[83] (the Yankees investment firm), without verification, a highly unusual practice.

On April 10, 2006 DOF announced that the assessed value of the Stadium itself was $1,025, 283,187. This figure was the total of hard costs of $749,396,309 and soft costs of $275,886,878. These numbers were supplied in a letter to DOF Assistant Commissioner Dara Ottley-Brown in a February 27, 2006 letter from Mr. Gregory Carey, a senior member of Goldman, Sachs & Co. DOF admits it accepted without independent inquiry Mr. Carey's assertion of Stadium costs.[84] In the documents provided to the Committee, in response to questions at a meeting with DOF staff, and by DOF's admission in its April 10, 2006 letter, DOF did nothing to verify these numbers, or to seek an independent verification of them.

After seeking advice from reputable assessment professionals, the Committee has identified a number of areas of concern with the Carey/Ottley-Brown numbers.

First, it is not customary assessment practice to receive and accept such cost numbers from financial advisors to a taxpayer, without verification or inquiry. It is customary and best practice for these numbers to be certified by a project engineer or other construction professional in a "certified cost schedule". DOF's decision not to seek verification of Mr. Carey's numbers requires further inquiry and clarification.

Second, various categories of cost asserted by the Yankees and accepted by DOF seem unusual in both their nature and their value. The Committee has been advised that two categories of cost given to DOF by the Yankees, $25 million for "Equipment and Furnishing" and $17.5 million for "Audio Visual Systems", are not normally included in replacement value assessments. While they do have business value they are not usually associated with real property values.

Third, the same concern is raised by the inclusion in real property value of $53 million for "Luxury/Sky/ Boxes". While this description is inherently unclear, it would appear that aside from construction costs accounted for elsewhere, these costs are best understood as part of a category of costs known as "Furniture, Fixtures, and Equipment", again not normally part of real estate costs.

Fourth, it appears that the Yankees included two similar categories of cost, $36 million for "Escalation", and $34 million for "Project Contingency" It is unclear what is included here, and whether these costs overlap.

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[82] These costs are outlined in a February 27, 2006 letter from Gregory Carey to Dara Ottley-Brown.
[83] April 10, 2006 letter from Dara Ottley-Brown (NYCDOF) to Gregory Carey (Goldman, Sachs & Co).
[84] It slightly revised his assertion of hard costs, increasing it by about $2.5 million.

Fifth, certain soft costs seem unusually high. The Yankees included $119 million for "Architectural, Engineering, and Development Costs", and $122.5 million for "General Conditions and Fees (Financing Costs)". The Committee has been advised that this amount of soft cost is unusually high, amounting to over one-third of hard costs, and slightly under one-quarter of total costs. It is also unclear if elements of financing costs including certain reserve funds are properly included in a real property assessment.

Sixth, it appears that the Yankees included costs for the construction of property not legally part of the Stadium, particularly the cost of construction of a new police station. The new station is explicitly exempted from the ownership agreements governing the new Stadium: "Police Substation is neither part of the land or property leased to the Agency under the Ground Lease, nor the land or property leased to the Company under the Lease Agreement."[85] Since the police station is not legally part of Yankee Stadium, it appears that standard practice would be to reduce includable costs by the amount of the construction cost of the station. This was known to the City and attorneys for the Yankees. In an e-mail dated December 6, 2006, Robert LaPalme of NYCEDC said "The IDA excludes the substation parcel, but the tentative tax lot appears to include it."[86] Apparently, DOF was not made aware of the existence of this entire matter and took no action on it. DOF responded to the Committee's question about the police station by saying "Our records don't indicate a police station on the site."[87] In a second letter DOF admits "the lot estimates we received did not mention a substation, and our valuation did not take into account a substation." [88] The DOF assessment includes the police station which appears to have inflated the assessed value of the Stadium.

These matters are highly technical, and no definitive conclusion on the legality or propriety of any individual cost can now be reached. The Committee did repeatedly seek all documents in the possession of DOF which might have explained these actions, and whether they constituted normal DOF practice. The Committee has been told they have received all documents in the file, and concludes that in the absence of any documents clarifying these decisions, having has sought expert opinion on these maters, and based on its own understanding of the law and accepted assessment practice, there is a need for further investigation of the actions of DOF in assessing the Stadium facility.

3. The Cost Per Seat Comparison

In the April 10, 2006 letter and subsequently the City has asserted that despite whatever defects may exist in its assessment of the land and the Stadium facility a comparison of a per seat cost with other stadia around the country indicate that the costs are comparable. After asserting that the per seat costs of Yankee Stadium is $19,345, the April 10, 2006 letter states:

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[85] Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of The IRS Code of 1986. Exhibit C – Certificate of The City of New York regarding Stadium. Section 3.
[86] December 6, 2006 e-mail from Robert LaPalme (NYCEDC) to Steven Lefkowitz.
[87] August 28, 2008 letter from Sam Miller (NYCDOF) to Chairman Brodsky.
[88] September 15, 2008 letter from Sam Miller (NYCDOF) to Chairman Brodsky.

"Building Cost Other Stadiums

The cost per seat for the following stadiums adjusted to New York Cost.

Washington DC:	$19,227
Minnesota:	$17,809
Oakland:	$17,049"

It is unclear what "adjusted to New York Cost" means. In any event, an independent review of publicly available stadium data for the three stadia shows per seat numbers dramatically lower than those claimed by DOF. The per seat cost calculated from the publicly available information provided by the respective stadia owners shows a value for the Washington stadium at $12,255.85, for the Minnesota stadium of $11,917.21 per seat, and a per seat cost of $14,285 at the Oakland stadium. These are all well below the DOF numbers. The Committee is continuing to try to reconcile these dramatically different estimates of per seat cost. The full calculations and sources of data used by the Committee are found in Appendix B.

4. The Dollar Value of the Inflated Assessment

The final assessed value of the underlying land and the new Stadium, as provided in the April 10, 2006 DOF letter totaled $1.229 billion.[89] The evidence that this is an inflated value is repeated, unexplained, and persuasive. The worst case estimate of the dollar value of the inflated assessment of Yankee stadium is approximately $180 million in land value and is as much as $220-225 million in hard costs, or about one-third of the total assessed value. It is unclear what effect a lower more accurate assessment would have on PILOT payments and debt service payments. The evidence of over-valuation is more than sufficient to require an independent, outside investigation.

VI. Luxury Suites

The NYCIDA and the Mayor's office decided to use bond proceeds to purchase a luxury suite for use by City officials at the new Yankee Stadium.[90] This decision illuminates the IDA and the City's failure to publicly address the wide range of issues raised by the Stadium deal. The decision to acquire the suite and additional game tickets, the failure to disclose it, the continuing failure to explain the reasons it was acquired, the initial denial by the Mayor's Office that it had been acquired, the failure to explain the funding source for the tickets, and the apparent lack of a policy for determining who gets the tickets or access to the suite are the kind of things that should have been publicly discussed and weren't.

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[89] April 10, 2006 letter from Dara Ottley-Brown (NYCDOF) to Gregory Carey (Goldman, Sachs & Co.)

[90] Tax Certificate. Page 16. Section ix, Use of Stadium: "Under the Lease Agreement, the Agency is entitled to use 1 luxury suite at the Stadium, which right is assigned to the City. The allocable cost of the luxury suite will be allocated to proceeds of the Taxable Bonds. The Lease Agreement also provides the Agency with certain other rights, including the option to purchase certain tickets for events at the Stadium..."

VII. The Price of Tickets at the New Stadium

The price of tickets to the new Yankee Stadium is a matter of legitimate public concern, given the enormous public subsidies involved. Since the Stadium deal was announced the Yankees have announced massive ticket price increases. It is unlikely that average middle class New Yorkers, whose tax payments subsidize the new Stadium, can afford regular access to most seats.

One of the differences between a sports facility and the typical NYCIDA project is that public access to a Stadium is a function of the price to the public of event tickets. At a privately financed facility, the private owner charges any ticket price people are willing to pay. When the public subsidizes a sports facility, however, there is a public interest in assuring that the people who are paying for the facility afford to can attend events there. Unfortunately the public interest in affordable access to Yankee Stadium was never a concern of the City of New York, or any of the public entities that structured the deal.

The Committees are still seeking information from the NYCIDA and the Yankees on the total revenue generated by the ticket price increases. Although the information is still anecdotal, tickets that the Yankees sold for $100 to$150 per game are now being offered for between $850 to $2500 per game. Tickets in other price ranges are also being increased by five to ten times, at least. Whatever opportunity low or middle income families have of attending a Yankee game in any other than the cheapest seats has vanished, at the same time that these same taxpayers are pouring hundreds of millions of their dollars into the building of the Stadium.

It is difficult to understand why the City, the NYCIDA, ESDC, and other public decision makers failed to even consider whether the right of the public to access to the new Stadium was an interest that ought to be protected. When asked at the Committee hearing whether the NYCIDA knew of the price increases, or was concerned about their impact, or viewed them as a factor in deciding whether to provide financial assistance, NYCIDA President Pinsky said:

> No, no. We considered it in the context of whether the stadium, given those median revenues, would be affordable to the Yankees, who were paying for the stadium....[91]

President Pinsky offered further a defense of the decision not to consider ticket prices as part of a public benefit analysis:

> When you ask a private company to invest a billion dollars somewhere, then it's hard to tell them that they can't charge ticket prices that allow them to pay for that billion dollar investment. Just like if they were IBM.[92]

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[91] July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 74.
[92] July 2, 2008 public hearing: Ibid. Page 76.

This asserted free-market defense of the Yankee ticket increases fails to meet the most basic test of rationality and fairness.

The Yankees, in a free-market system, have the right to charge whatever they wish. Once they accept large amounts of public subsidy however, they have or ought to have a responsibility to the public which funds their efforts. The inability of the NYCIDA to understand this is distressing. But Mr. Pinsky's assertion that the Yankees are operating in a system where the market sets the price is astoundingly wrong. The Yankees, along with all of baseball, benefit from an exemption from federal and state anti-trust laws. They are a legal monopoly. They can and have engaged in anticompetitive practices, and control the market for their tickets in ways that would violate the law for any other industry. The NYCIDA, the City and other public entities are subsidizing a monopoly. To compare it to IBM, which operates in a competitive market, illuminates NYCIDA's the failure to protect the public interest in almost every aspect of this deal.

It also appears that the NYCIDA failed to consider the huge increase in ticket revenue to the Yankees as relevant to whether or not they needed, or qualified for, public financial assistance.

The problem of huge ticket price increases after huge public subsidies has not gone unnoticed. Legislation to address this problem has been introduced by Assemblyman Brian Kavanagh of New York County and 25 Assembly colleagues.[93] Additional legislation to insure that NYCIDA subsidies of places of public access at least consider the ticket pricing policies is also being drafted.

VIII. Request for Additional Financing

When the initial agreement for subsidized tax exempt financing for the new Stadium was announced, it was in the amount of $920 million in tax exempt bonds.[94] There was no indication that additional financing would be sought or approved. To complicate matters, the IRS, which had expressed concerns about tax-exempt financing for sports facilities at the time of the initial approval, has issued a proposed regulation, which would make it difficult if not impossible to issue new Yankee Stadium-NYCIDA debt. Even with that obstacle unresolved, the Yankees are now seeking an additional $366.9 million[95] in tax-exempt financing, as evidenced by a "preliminary" application to the NYCIDA. The application itself, as redacted by the NYCIDA[96], does not make clear what the specific purposes of the new financing would be. They mention a vague category of "Scope Modifications" in the amount of $196 million, but do not specify exactly what these are.[97] The Yankees have asserted that the financing is for the purpose of "completion" of the project, something that was anticipated in the initial financing. Press reports, and some additional information

[93] New York State Assembly Bill 11692.
[94] August 16, 2006 NYC press release: "Mayor Bloomberg, Governor Pataki and New York Yankees Break Ground on New $800 Million Stadium"
[95] Annex 2-6 to Yankees Core Application to NYCIDA.
[96] The Committee does not support or accept the decision to redact this information.
[97] Annex 2-6 to Yankees Core Application to NYCIDA.

supplied by the NYCIDA indicate the bulk of the money is for an expanded audio visual system, probably a large video screen, improved washrooms and vertical transportation, among others.[98] It is unclear if the audio visual and washroom costs are properly funded by tax-exempt construction bonds.

Several unanswered questions have arisen. First, are the purposes for which the funding is sought valid public purposes sufficient to justify the funding as both a matter of policy and as a matter of law? The most unclear issue is related to the NYCIDA Deviation Letter in the initial financing. In that letter the NYCIDA asserted that the threat that the Yankees would leave the state provided the justification for the financing. Although there is little evidence to back that assertion (see pages 9 through 11), there is absolutely no basis for a new threat to leave especially since there is now a non-relocation agreement. Accordingly, if the original Deviation Letter is to be believed, there is no legal basis for the second round of financing.

IX. Use of PILOTs to Create Debt

The use of PILOTs to back tax-exempt quasi-public debt is crucial to the Stadium deal.

PILOTS were created as a means of evading the constitutional requirements that all taxpayers be treated equally and that public funds not be given to private persons for their private benefit. While PILOTs can be granted directly by a municipal government, an NYCIDA may take ownership of a private asset and then simultaneously lease the asset back to the private owner, thereby relieving the private owner from any legal obligation to pay property taxes. Instead of those property taxes, the government/NYCIDA negotiates the PILOT at a lower amount than the tax that would otherwise be owed. That tax saving is a subsidy by the public to the private project that meets constitutional requirements: "The fixed amount of PILOTs represents a reduction from the amount of real property taxes that would have been imposed on the Stadium and Stadium Site..."[99]

State law requires that PILOT revenues be returned to the government for general government budgetary purposes: "Payments in lieu of taxes received by the agency shall be remitted to each affected tax jurisdiction within thirty days of receipt."[100] The theory is that the government gets reduced revenue, but a project that creates economic growth for the whole community will be built.[101] It is that latter benefit which provides the pretext for the public subsidy.

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[98] July 17, 2008 letter from Irwin Kirshner (Herrick) to Robert LaPalme (NYCEDC).

[99] Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of The IRS Code of 1986. Page 16, Section d.3.v

[100] Section 874 (c) of New York State General Municipal Law

[101] However, "Last year, discounted PILOTs amounted to $107 million in lost revenue to the city, with abatements averaging a whopping 60% per company." Juan Gonzalez. "Deals that Lead to Lost Property Taxes." Daily News. December 20, 2007. Figures are based on a Report of all PILOT revenues and expenditures sent from the City Office of Management and Budget to City Council Speaker Christine Quinn.

Recently, New York City, and perhaps others, have advanced a novel financing scheme. Instead of going into the municipal treasury for schools, transit, health care or other municipal purposes, the PILOT payments are pledged to pay off debt. Because this new PILOT debt is technically not municipal debt, it is off-budget, off-book, not subject to the usual requirements of disclosure and legislative control, and in the case of New York City, apparently not included under the municipal debt limit required by state and City enactments. This has resulted in an explosion of quasi-City debt, literally billions of dollars, that is little known, and which is actually repaid by municipal revenues.

Originally, the Mayor took the position that such debt could be issued directly by him, with no other approval. But, since the PILOT is a payment to the government and public property, there was no satisfactory way to explain how the PILOT funds made their way into the pockets of private citizens who owned the NYCIDA bonds. There was no approval by the legislative body, no budget action, no appropriation, and no public accountability other than the desires of the Mayor. In the face of this critique, the City Council, in 2005, passed Local Law 73 and later Resolution 259, which sought to give legislative approval to this debt creating scheme. It remains unclear if this Council action was legally effective, and unclear whether State law permits the use of PILOTs in this way.

A final judgment on the legality of securitized PILOT's is beyond the scope of this Interim Report. It is a matter of deep public concern as it resembles the private sector "off-book entity" machinations of recent years, which in the case of Enron and others showed the disasters that can result from unrestricted debt issuance backed, in this case, by public funds and institutions. The Committee is engaged in an effort to estimate the total public debt that has resulted from this new mechanism. If, as may be, there is no sound legal basis for such debt, than the Stadium deal, as well as many others, will be in difficulty.

X. The Role Of Elected Officials

From the beginning of its' inquiry the Committee have been seeking to determine the role of elected officials in the important decisions surrounding the Stadium deal. It seems obvious, and consistent with text book democratic theory, that decisions of this magnitude, including the issuance of billions of dollars of public debt, should be made by the elected representatives of the people. That is not the case. In this deal, as with a series of similar deals all over the state, executives' use of public authorities has created a parallel and all-powerful model of the decision to issue public debt. These executives, mayors, governors, county executives and supervisors, have sought and received legislative permission to create these new public authorities and although not legally empowered to do so, have controlled their decisions by appointing authority boards that see themselves as subordinate to the wishes of the Executive who appointed them. As a matter of law, the decision to provide billions of dollars of public financial assistance to the Yankees was made by the NYCIDA Board, whose current members are: Seth Pinsky, Derek Park, Amanda M. Burden, Michael A. Cardozo, Albert V. De Leon, Steven C. Devereaux, Robert C. Lieber, Joseph I. Douek, Kevin Doyle, Andrea Feirstein, Bernard Haber, Albert M. Rodriguez, Robert D. Santos, William C. Thompson.[102] With all due respect to these public-spirited and well-intentioned

[102] NYC IDA website.

citizens and government employees, it is unlikely many New Yorkers have heard of them, or wish them to be vested with the enormous power they now wield.

When asked about this issue, Mr. Pinsky replied that only the Mayor of New York City needed to be involved in such decisions:

> Chairman Brodsky: Does it seem to you that this is a matter of such public importance that elected officials ought to be driving the decision?
> Mr. Pinsky: Like the mayor, sure.
> Chairman Brodsky: Other than the mayor, are there any elected officials worthy of participation in this?
> Mr. Pinsky: No.[103]

In fact, the decision to go forward with the Yankee deal was largely the decision of the Mayor, and the NYCIDA admitted as much. In a June 30, 2006 letter to the IRS, Mitchell Rapaport and Bruce Serchuk (of Nixon Peabody LLP), counsel to the NYCIDA explicitly admitted that the deal was not in the control of the NYCIDA, but had been "negotiated with the City,"[104] apparently meaning the Mayor.

It is not in the public interest for the decision to issue billions in public debt to be made purely by the executive, outside the constitutional system of checks and balances. The State Legislature, the City Council, and others concerned about the governance of public institutions, and the proliferation o public debt, need to address these complicated, formal and informal, executive driven, and secretive institutional arrangements. One can hardly expect enormously wealthy private entities such as the Yankees to avoid the riches showered on them by these deals if elected officials themselves do not examine and control them.

XI. Findings

A. The New Stadium Will Not Create Any Significant New Permanent Employment or Economic Activity

In exchange for $500 million to $1 billion in public subsidies proponents of the new Yankee Stadium deal claimed there would be significant economic benefits to the people of the City and the State. Unfortunately as measured by permanent new job creation, new private sector investment, new local economic activity and other factors, the new Yankee Stadium will yield little if any public economic benefit, in spite of legal requirements otherwise.

The growing national evidence and the growing national public conclusion is that sports facilities are not sound economic investments for taxpayers.

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[103] July 2, 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City. Page 138.
[104] June 30, 2006 letter from Mitchell Rapaport and Bruce Sercuck (Nixon Peabody, LLP) to Rebecca Harrigal (IRS). Page 1.

> ... stadiums typically don't have a significant financial impact on the communities in which they are located. That's especially true, he said, when teams relocate to a new stadium that has fewer seats and higher ticket prices. ....[Neil DeMause, co-author of "Field of Schemes: How the Great Stadium Swindle Turns Public Money into Private Profit"] said that research shows stadiums have 'no measurable impact on per-capita income' and do not revitalize urban neighborhoods that surround them."[105](See page 12 above.)

State laws recognize the need for measurable public benefit when subsidies are offered. The NYCIDA evaded these statutory requirements and refused to acknowledge the basic economic truths about the Stadium deal. The confusing and contradictory justifications made in the NYCIDA Deviation Letter and Inducement Resolution illuminate the lack of any persuasive economic data showing a public benefit.

The application the Yankees filed with the NYCIDA disclosed that only 15 permanent new jobs were to be created, and only 71 part-time jobs[106], the stadium was a "retail" project of a kind disfavored by the NYCIDA law, that and there was little of new permanent economic benefit to the host communities in the Bronx. The percentage of Yankee employees actually residing in New York City, and therefore the amount of economic benefit to New York City residents, is relatively low. Only about 50% of full time Yankee employees were New York City residents at the time, and only approximately 20% of part time employees.[107] (See page 8 above.)

The NYCIDA, and the Mayor, who are charged by law with assuring that public benefits do exists, took two conflicting official positions. In the required "Deviation Letter", the sole reason given in support of public financing was a purported Yankee threat to relocate out of the City. There is no evidence that the Yankees actually made such a threat. However, in the required NYCIDA "Inducement Resolution" the NYCIDA and the Mayor are silent about a relocation threat, and assert that "The Project will serve the Agency's public purposes by preserving or increasing the number of permanent private sector jobs in the City and State of New York", apparently referring to the 15 new permanent jobs described by the Yankees in their application to the NYCIDA.[108]

This inconsistency not only raises substantial questions about the legality of the NYCIDA approvals, it illuminates the difficulty Stadium proponents had in meeting the traditional standards for economic growth and development. Whatever emotional or political benefits result from public financial assistance to the Yankees, the economic benefits are slight or non-existent, while the public costs, estimated at over $700 million, are enormous, at a time when other pressing capital needs go begging.

The decision to spend this public money on Yankee Stadium was not in the public's economic interest.

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[105] Herbert, Keith and Michael Frazier. "Do Public Subsidies Pay Off?" Newsday. July 2, 2008.
[106] Yankees Core Application to the NYCEDC, page 7.
[107] Yankees Core Application to the NYCEDC, page 7.
[108] Tax Certificate. Exhibit E. Page 2.

B. The Public, Not The Yankees, Is Paying The Cost of Constructing The New Yankee Stadium.

Taxpayers are paying the cost of constructing the new Yankee Stadium despite repeated claims to the contrary by City officials: "Funding for the $800 million in construction costs is being provided fully by the Yankees." (See page 3 above.) These statements are simply not true. The cost of construction is being paid by diverting tax payments the Yankees are legally obligated to make to New York City to repayment of the tax-exempt bonds floated by the NYCIDA.[109] The City repeatedly in legal documents admits that it is taxpayer money, not Yankee money, which is building the new Stadium. "The City has determined to use its property taxes (in this case PILOTs) to finance the construction and operation...of the Stadium."[110] These PILOT payments are in fact taxes owed. "City PILOTs are the only way that the City can treat the real property as if it were subject to real property taxes".[111] Without the PILOTs "...the Stadium would be subject to full real property taxes."

The best that can be said about the public assertions that the Yankees were paying for the Stadium is that they were politically necessary to keep the deal alive. But when it came time to describe the transaction in legally binding ways to the IRS, the truth had to be told. Simple common sense yields the same conclusion. No homeowner, no commercial developer, could build a new building, and then demand that the taxes owed to the locality be sent to the bank to pay off the mortgage, and then claim it was their money paying for the building.

Whatever other justifications exist for public support of Yankee Stadium, the assertion that the Yankees are paying to build it are untrue and should cease.

C. The Actions Of The NYCIDA Did Not Protect The Public Interest, And May Have Violated The Law.

The NYCIDA manipulated and evaded State law requirements that there be a public economic benefit in exchange for the massive public subsidies received by the Yankees. The NYCIDA was created by state law as a vehicle to enhance economic growth and development, but only where there was a demonstrable public economic benefit that resulted. No such public economic benefit can be shown in the Yankee deal. "...the transaction results in private business use of the proceeds of the Tax-Exempt Bonds...."[112] The gyrations of the NYCIDA as it sought to find any benefit, the conflicting reasons it has given for the subsidies, and its' complicity in the dubious actions of other agencies are a matter of grave policy concern. The state law which governs NYCIDA actions should be amended to end these abuses, to require broader disclosure of key elements of its projects, to assure a real public benefit in exchange for public subsidies, to end the abuse of the

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[109] This diversion of tax payments is done by the use of Payments in Lieu Of Taxes (PILOTs).
[110] February 1, 2006 letter from Mitchell Rapaport and Bruce Serchuk (Nixon Peabody) to IRS. "NYCIDA – Request for Private Letter Ruling Under Section 141 of the Internal Revenue Code." Page 47.
[111] February 21, 2006 letter, Ibid. Page 22.
[112] February, 1 2006 letter, Ibid. Page 47.

UTEP process through "deviation letters", and to limit the unfettered and explosive growth in NYCIDA sponsored public debt.

Both the NYCIDA and the State law governing IDAs are in need of fundamental overhaul and reform.

D. The NYCIDA Should Not Be Used For The Creation Of Massive Amounts Of Public Debt. Such Use May Violate Existing Law.

The NYCIDA alone has created billions of dollars of new public debt with little transparency or control by elected officials and outside of existing debt restrictions. This is not in the public interest. The broad attack on the growth of public debt should be accompanied by a recognition that the vehicles for the debt increase are relatively new schemes to avoid existing debt restrictions. The use of public authorities, Local Development Corporations, and other "off-book" entities presents a clear and present danger to the fiscal health of the State City and region.

The securitization of PILOTs as a new way to create unrestricted public debt may not be legal. The Mayor's original assertion that he could create such debt through these new entities without legislative approval was clearly beyond the law. Whether or not the City Councils actions cured that defect in City actions is unclear. Whether or not state law permits such machinations is also unclear should be examined. If state law does permit such debt issuance it should be amended to contain reasonable standards protecting the public interest and procedures to assure transparency and fairness.

E. The NYCIDA's Refusal To Consider The Issues Of Ticket Prices And Public Access To The New Yankee Stadium Was A Failure To Protect The Public Interest.

The NYCIDA refused to protect the public's interest in affordable ticket pricing at the new subsidized Yankee Stadium and failed to consider the new revenue bonanza the Yankees will receive as a result of dramatic ticket price increases. The public has a real interest in affordable access to facilities it subsidizes. The Yankees right to charge any price they wish for tickets ended when the sought and received public subsidies. The NYCIDA and the Mayor's Office should have insisted that ticket prices and public access be part of their negotiations over the subsidies, and that the enormous spike in revenues the Yankees will receive be considered in determining the level of subsides to be given to the Yankees, if any. The failure to consider the public interest in ticket prices and affordable access to NYCIDA projects, and many other concerns should be reviewed and, where needed, changed.

F. The Tax Assessment Practices of DOF, For Yankee Stadium And Elsewhere, Need Immediate Independent Review.

The NYCDOF inflated the assessed value of the new Yankee Stadium despite sworn promises by New York City that it would not. It did so, in all probability, to qualify the Stadium project for tax exemptions. The decisions and actions by DOF with respect to its assessment of the land and facility at Yankee Stadium are disturbing, and may have violated

legal requirements. These actions include use of out-of-community comparables, failure to make appropriate adjustments, failure to accurately state the location of comparable parcels, failure to accurately state the acreage involved, wide disparities in assessed value of land in the Yankee Stadium area, the existence of two other City appraisals of the property at much lower values, uncritical acceptance of information from the Yankees without certification or independent review, failure to exclude non-Stadium costs, and acceptance of unusual costs as part of the facility replacement cost. The consequence of these actions is an assessed value for the Yankee Stadium project that is inflated by as much as one-third.

An immediate, thorough, and independent review of this assessment, and assessments elsewhere in the Stadium neighborhood, and perhaps elsewhere in the City, is required.

G. New York City's Acquisition Of A Luxury Suite And Yankee Tickets Was, At Best, Unwise.

The NYCIDA and the Mayor's office decided to use bond proceeds to purchase a luxury suite for use by City officials at the new Yankee Stadium. This decision illuminates the IDA and the City's failure to publicly address the wide range of issues raised by the Stadium deal. The decision to acquire the suite and additional game tickets, the failure to disclose it, the continuing failure to explain the reasons it was acquired, the initial denial by the Mayor's Office that it had been acquired, the failure to explain the funding source for the tickets, and the apparent lack of a policy for determining who gets the tickets or access to the suite are the kind of things that should have been publicly discussed and weren't.

H. There Is An Immediate Need For Thorough, Independent Reviews Of The Actions OF DOF, NYCIDA, And Other Public And Private Parties.

The Committee will continue its' inquiries and issue a Final Report. That Report will contain specific recommendations for statutory, administrative and operational reforms of the various public and private entities involved, and may refer the Final Report to other investigative bodies for appropriate action. But the facts and conclusions contained in the Interim Report are sufficient to cause other independent investigations to begin immediately.

Appendix A
Thi information was derived from private and public websites.

	Block	Lot	AV	FMV	S.F	FMV/S.F
101 E. 157th (parking lot)	2483	1	65,250	145,000	10,300	14.08
810 River Ave. across from YS		5	156,600	348,000	20,000	17.40
90 E. 158th St. (apt. Cor Gerard)		15	80,100	178,000	19,695	9.04
107 E. 157th (apts corner Gerard)		23	80,100	178,000	19,695	9.04
81 E. 158th St. across from YS		32	39,510	87,800	3,948	22.24
844 River Ave.		34	138,150	307,000	15,017	20.44
48 E. 161st St./S.E. cor.		40	720,000	1,600,000	9,061	176.58
58 E. 161st St./store mid-block		44	180,000	400,000	2,500	160.00
62 E. 161st/store S.W.cor Ger.		45	765,000	1,700,000	12,190	139.46
845 Gerard/midblock apts.		53	64,350	143,000	14,375	9.95
831 Gerard Ave./apts. On 158th.		59	66,150	147,000	16,200	9.07
83 E. 158th St. 2-story garage		68	168,750	375,000	9,800	38.27
		158	824	1,831	300	6.10
			2,524,784	5,610,631	153,081	36.65
940 River Ave. full-block garage	2485	1	981,000	2,180,000	130,600	16.69
Garage A-big site	2499	100	1,120,500	2,490,000	240,405	10.35
Garage C-small site	2499	1	369,000	820,000	62,859	13.04
Garage B	2493	9	612,000	1,360,000	68,828	19.75
New Yankee Stadium	2493	1	78,750,000	175,000,000	634,335	275.88
Old Yankee Stadium	2491	1	3,150,000	7,000,000	424,760	16.48
Old Macombs Dam Park ('06)	2492	1	2,691,000	5,980,000	464,916	12.86

	Block	Lot				
586 Cromwell Bronx HOD.	2357	1	1,080,000	2,400,000	207,383	11.57
	2354	74	211,500	470,000	38,365	12.25
590 Exterior	2356	20	258,750	575,000	24,800	23.19
65 E. 149th St.	2356	2	423,900	942,000	191,500	4.92
671 River Ave.	2357	86	118,800	264,000	37,665	7.01
Under Major Deagan	2539	60	411,300	914,000	66,500	13.74
587 Cromwell	2539	32	1,710,000	3,800,000	460,800	8.25
				9,365,000	1,027,013	9.12
120 E. 149th St. (Hostos)	2350	39	179,550	399,000	17,600	23
Citifield Site	1787	20	109,988,198	244.418,217	2,747,985	88.94

	Block	Lot	AV	FMV	S.F	FMV/S.F
51 E. 161st St.McD N.E.	2484	5	326,250	725,000	11,503	63.03
880 River Ave.		9	198,000	440,000	19,306	22.79
60 E. 162nd St. cor.apts		15	137,700	306,000	20,802	14.71
881 Gerard Ave. supmkt		33	89,550	199,000	13,600	14.63
67 E. 161st NWCor.Ger		35	199,350	443,000	11,503	38.51
Totals/Avg For Block			950,850	2,113,000	76,714	27.54

Both A average 10.98

possibly 107,965(include/street

997,132 Square Building, No improvement Value

up from 250,000 in '03
down from 1,060,000 in '03

up from 349,555 in '03

Mr. KUCINICH. Thank you very much, Assemblyman Brodsky. Professor Gillette, you may proceed.

STATEMENT OF CLAYTON GILLETTE

Mr. GILLETTE. Thank you, Mr. Chairman and committee members, for the privilege of testifying before you today. My summary remarks this morning are intended to suggest the proper scope of the tax exemption should be tied to fostering democratic accountability and financial transparency at the local level. The use of PILOTs, at least as structured in the Yankee Stadium deal, does not readily meet that test.

Any analysis of the proper scope of the tax exemption must begin with the proposition that the exemption constitutes a subsidy from the Federal Government to the entity that benefits from the proceeds of the debt. There are two circumstances under which a Federal subsidy to projects initiated by State or local governments is appropriate. The first involves projects that are positive external effects; that is, projects that return benefits beyond the jurisdiction that utilizes the funds.

The second category of projects that warrant Federal subsidy encompasses those that enhance the autonomy of local governments generally. Autonomous localities can experiment with government projects that, if successful, can be copied elsewhere, can encourage an efficient sorting of local public goods, and can confer broader social benefits by attracting a tax base that will be more productive in the attracting locality than in alternatives.

If the purpose of the exemption is to enhance local economy, however, it is crucial that the subsidy be used in a manner that actually reflects local preferences rather than simply deals between local officials and groups that have disproportionate access to the local decisionmaking process.

Current Federal tax law maps on to this template closely. First, it provides a relatively broad exemption for bonds issued that will have projects of multi-jurisdictional effects. In addition, Federal law permits the exemption to be used to foster local conceptions of the ideal mix of public goods, but—and this is an important condition—Federal tax law contains a variety of provisions that can best be understood as imposing on a locality the obligation to ensure that the decision to undertake a subsidized project does, in fact, reflect the preferences of local residents.

For instance, locality may take advantage of the Federal subsidy, even for a sports stadium, if it is willing to finance the stadium from municipal revenues that have been generated by the traditional taxing mechanism used by the city to fund the public goods and services that it provides, what are referred to in the Treasury Department regulations as generally applicable taxes.

Expenditures made through this process are likely to have been subjected to an appropriations competition for scarce resources in the municipal budget that ensures transparency, monitoring of the municipal budget by taxpayers, and therefore an outcome that is likely to reflect expenditures that constituents actually prefer.

Even qualified private activity bonds that are eligible for the tax exemption include requirements that enhance transparency and democratic accountability in the local decisionmaking process. For

instance, most forms of private activity bonds are subject to a volume cap imposed on jurisdictions. The volume cap serves as an effective substitute for the benefits of the budgetary process by creating competition for projects that are eligible for tax-exempt financing.

Finally, a private activity bond is not eligible for the Federal exemption unless the governmental issuer approves the bond after a public hearing following reasonable public notice or through a voter referendum.

Now, how do payments in lieu of taxes [PILOTs], fit into this scheme? The answer to that question, I submit, affects the difficult inquiry into the conditions on which PILOTs should qualify as generally applicable taxes rather than private payments, since PILOTs have characteristics of both.

In resolving this ambiguity about the proper characterization of PILOTs, I submit it is useful to consider how they fit with the issues of transparency and democratic accountability that I have argued pervade generally applicable taxes and other features of Federal exemption. PILOTs may lack transparency and susceptibility to monitoring, at least to the extent that they are treated in municipal budgets differently than taxes, are dedicated to particular payments rather than paid into the local treasury appropriated in the same manner as other expenditures, or are treated as contract revenues to be transferred or disposed of through a process that varies from and is less observable than appropriations from a fixed budget.

For instance, the mayor of the city of New York has taken the position that PILOTs constitute contractual rights that have been individually negotiated by the city rather than tax payments, and, as such, the mayor's offices claim that PILOTs are not revenues of the city susceptible to payments to the general fund controlled by the City Council; instead, they are arguably, in his view, assignable to city projects within the discretion of the mayor.

Indeed, the difficulties related to monitoring the use of pilots are exacerbated to the extent that PILOTs are deemed by applicable taxes, so that the bonds they secure qualify as governmental bonds rather than private activity bonds. Under those circumstances, failure to treat PILOTs in the same manner as tax revenues paid into and appropriated from the municipal treasury through the normal budgetary process means that the bonds that they secure will not be scrutinized through the monitoring process that typically applies to municipal revenues.

On the other hand, because these bonds are not private activity bonds, they are also not subject to the alternative means of assuring transparency and monitoring, such as volume cap and the public approval requirements. In short, at least to the extent that PILOTs are treated differently from taxes, they permit evasion of the democratic scrutiny that ensures that federally tax-exempt projects and financing structures reflect constituent preferences and serve the objectives of local autonomy.

None of this is to say that the use of PILOTs to finance local projects is illegitimate. If the State or locality believes the PILOTs are desirable, that jurisdiction should be perfectly free to employ that structure. But nothing about the fact that PILOTs are useful

from a local perspective requires that the Federal Government allow use of a Federal tax subsidy to support it. Indeed, it is plausible that by disadvantaging opacity in public finance, Federal tax law can actually provide useful incentives for the reform of an anachronistic procedures in State and local finance.

My thanks for your time and attention. I would be pleased to answer any questions you might have.

[The prepared statement of Mr. Gillette follows:]

Testimony of Clayton P. Gillette
New York University School of Law

Domestic Policy Subcommittee
Oversight and Government Reform Committee
2154 Rayburn HOB
Thursday, September 18, 2008
10:00 a.m.

Thank you Mr. Chairman and Committee members for the privilege of testifying before you. I am here to comment on the implications of the federal tax exemption on municipal bond interest for federalism and democratic governance, and the relationship between those implications and the financing of sports stadiums through payments in lieu of taxes or PILOTs. I am a professor at New York University School of Law. One of my areas of specialization is local government law, with some emphasis on local government finance. I am not, however, and do not purport to be a tax lawyer.

I. The Scope of the Federal Tax Exemption

My remarks today are directed at defining the proper scope of the federal tax exemption on interest for debt obligations of states and their political subdivisions, commonly called municipal bonds. Any analysis of that issue must begin with the proposition that the exemption constitutes a subsidy from the federal government to the entity that benefits from the proceeds of the debt. This subsidy is the consequence of the fact that issuers are able to sell their debt at lower interest rates than would otherwise be the case because the federal government is willing to forgo the income that it would receive by collecting tax on the interest that purchasers of the debt receive as ordinary income.

Moreover, there is a substantial argument that the tax exemption constitutes an inefficient subsidy in that it costs the federal government more in forgone income than it returns to the states and their political subdivisions in the form of reduced borrowing costs. To see how that is the case, consider that, according to Federal Reserve statistics, at the end of 2007, the yield on mixed-grade tax-exempt bonds was approximately 4.42 percent at a time when the yield on AAA industrial bonds was 5.49 percent. This means that an investor who was in the 35% marginal tax bracket and who purchased a $10,000 municipal bond would receive $442 annually in interest income on that bond. As a result of the federal tax exemption, none of that income would be

taxed and the investor would be left at the end of each year with all $442 in interest income. If the best alternative investment for the same investor would have been a taxable AAA corporate bond, he or she would receive $549 annually in interest income. But at a 35% tax rate, that investor would pay approximately $192 annually in federal income tax on that investment. The federal government, by virtue of the tax exemption on the municipal bond, has agreed to forgo this $192, minus the costs of collection. But note that the locality that issued the tax-exempt bond has only saved $107 – the difference between the $442 it had to pay in interest and the $549 it would have had to pay if interest on its bond had been taxable. The potential inefficiency, therefore, arises from the fact that, in order to confer a $107 subsidy on the issuer, the federal government has had to forgo income of $192, less the costs of collection. The amount of the inefficiency will depend on the yield ratio between tax-exempt and taxable bonds (or other alternative investment), which in my example from the end of 2007 was about .80, and on the effective tax rate of the investor. But for virtually any investor for whom purchase of a municipal bond rather than a corporate bond of equal quality would be financially beneficial, some inefficiency is likely to remain. This inefficiency may not be sufficient to eliminate the tax subsidy – any replacement for it could be equally inefficient. But the potential inefficiency does provide a reason to ensure that the scope of the exemption is properly defined to satisfy some purpose sufficient to justify the exemption.

It is important to note the nature of the subsidy inherent in the tax exemption, because it implicates the question of who is paying for, and who is making financing decisions for projects that purportedly serve locally determined public purposes. But it is also important to understand what is not implicated by the availability or unavailability of the tax exemption to subsidize particular projects. The claim is sometimes made that denial of the tax exemption interferes with local decisions about which capital projects to pursue or the transactional structure with which to pursue them. I believe that stating the issue in terms of interference or second guessing of local decisions mischaracterizes the effects of federal decision making. Even in the absence of an exemption, states and localities are perfectly free to pursue any project that they deem appropriate, consistent with state constitutional and statutory restrictions such as debt limitations, public purpose requirements, and prohibitions on lending of credit to private entities. The unavailability of the federal tax exemption only obligates the locality to pay the full market cost of its decisions, rather than to have part of those costs borne by nonresident taxpayers. But if

those nonresidents receive no benefit from the project, then it is unclear why the federal tax dollars that they pay should help to subsidize it. Indeed, from an economic perspective, we would want the locality to bear the full costs of the project, so that local officials have an incentive to balance the purported benefits of the project against its costs and to induce local residents to ensure that their tax dollars are being spent in a manner consistent with their preferences.

The inquiry into whether a project is desirable from a local perspective, in short, is independent of the inquiry into who should pay for it. We sometimes hear, for instance, the phrase "public purpose" injected into debates about the use of tax-exempt financing. It is important to understand that the phrase can mean very different things depending on whether it is used to refer to the propriety of a locality undertaking a project at all or to the propriety of federal participation in financing the project. A project that returns benefits that are wholly concentrated within the issuer's jurisdiction may well satisfy state constitutional "public purpose" requirements. But that fact alone does not entail that the same project constitutes a "public purpose" as that phrase is often used to describe the proper scope of the federal tax exemption. A project that confers no spillover benefits to other localities does not necessarily satisfy a federal public purpose, even if it satisfies a locally determined one. The same is true for financing structures. Funding mechanisms such as PILOTs may very well serve the interests of particular local governments, and state governments may have appropriate reasons to allow their use. But that is a very different issue from whether the federal government must make its subsidy available regardless of state policy. No principle of our federalism suggests or requires that the federal government must subsidize every project or transactional structure that localities seek to implement.

What, then, defines the conditions that justify availability of this federal subsidy? One way to think about this question is by analogizing the subsidy to its economic functional equivalent: a block grant made by the federal government that allows the recipient to use funds generated at the federal level for local purposes. This identity between grants and exemptions allows us to focus on those conditions in which the former are appropriately made by the federal government to states and localities, and thus provides some insight into the proper scope of the tax exemption.

There are two circumstances under which such a subsidy is appropriate. The first involves projects undertaken by states and localities that have positive external effects, that is, projects that return benefits beyond the jurisdiction that utilizes the funds. Assume, for instance, that a locality is considering construction of a project that could reduce pollution in multiple jurisdictions. Left to its own devices, that locality would presumably compare the local costs that it would incur by pursuing the project against the local benefits that it would enjoy. But it is plausible that by incurring additional costs, the project would create a higher level of control that would reduce pollution in neighboring jurisdictions as well as in the jurisdiction undertaking the project. The locality, however, has no incentive to confer benefits on those jurisdictions. Indeed, it has an incentive not to do so because enlarging the project would increase local costs, but would not increase local benefits. It would confer those benefits only on other jurisdictions that paid nothing towards the project. Thus, we would expect that the locality would only engage in the lower level of pollution control even though, from a social perspective, the higher level of pollution control was warranted.

If we wanted to induce the locality to engage in the higher level of pollution control, we could do so through a subsidy – for instance through a grant in an amount that equals the difference between the less expensive project and the more expensive project that generated the benefits that spill over into the neighboring jurisdictions. Tax dollars collected at the federal level from those neighboring localities that benefit from the larger project would thus be used to fund it. The locality would presumably be willing to engage in the higher level of pollution control because it was not paying the marginal costs of conferring benefits on neighboring jurisdictions. Another way to accomplish an equivalent subsidy, however, would be to provide a tax exemption on the interest that the locality would have to pay on funds necessary to obtain the capital to construct the pollution control project. That tax exemption would have the same effect as the grant insofar as it reduced the borrowing costs of the locality and made it indifferent between the more parochial project and the more expensive one that conferred benefits on neighboring jurisdictions. The amount of the subsidy that the federal government would be providing through a tax exemption might be only the roughest of approximations of the cost of providing external benefits, but such rough estimates may ultimately be less expensive than funding a federal bureaucracy to determine the precise costs of creating benefit spillovers for all locally funded projects that have such effects.

The second category of projects that warrant federal subsidy is a bit more nebulous, and arguably broader than those projects that generate benefit spillovers. Basically, this category encompasses projects that enhance the local autonomy of local governments generally. The benefits of autonomous local government are substantial. Given the latitude to experiment, entrepreneurial states and political subdivisions can generate projects and programs that, if successful, can be copied elsewhere, and that, if unsuccessful, limit the costs of failure. It was, perhaps, in this sense that Justice Brandeis famously referred to states as "laboratories."

Autonomous governments also allow individuals to pursue their own view of the best mix of publicly provided goods and services. Localities provide numerous public goods to their residents: roads, schools, open space, police protection, proximity to workplace, etc. But no local government can provide all public goods, and the provision of one set of public goods may preclude provision of another. Different localities will offer different baskets of public goods and services at particular tax prices, and mobile individuals will gravitate to those localities that offer the basket of goods and services most consistent with their own residential preferences. While this is a complicated subject, I think that most lawyers and economists who have studied the matter would agree that local sorting enhances the efficient delivery of local public goods by matching taxpayers with the goods and services they desire.

Autonomous local governments also confer broader social benefits by acting in a manner that attracts a tax base that they believe will help enrich their communities. This interlocal competition, in theory at least, induces firms to locate where they will be most productive and induces localities to improve their educational and social services that productive firms would find attractive. In order to encourage local entrepreneurial behavior, the federal government has an interest in projects that may generate benefits that are wholly internal to the locality, but that, if successful, would benefit other localities as well. The federal government, in effect, may serve as a venture capitalist with respect to certain projects.

If local autonomy produces these broad social benefits, then it is appropriate for the federal government to subsidize local activity that advances the capacity of localities to pursue autonomous conceptions of entrepreneurial, competitive, and governmental activities, as long as those activities do not run afoul of broader social objectives. The broad social benefits that can be realized through local autonomy are possible only if localities have the capacity to provide the

basic services that we think are best administered at a decentralized level: basic government, education, social services, and a judicial system. Thus, federal subsidies are appropriate to ensure that localities possess the basic infrastructure and capital capacity that is a prerequisite to more productive local government. A federal subsidy that provides broad discretion to localities to implement projects that they deem useful is likely to serve that objective better than targeted grants that implement a more centralized view of what localities ought to do. A federal tax exemption has the potential to play the desired role insofar as it fosters local autonomy. I will argue momentarily, however, that if the objective is to enhance local autonomy, it is crucial that the federal subsidy be used in a manner that actually reflects local preferences.

II. Is Current Law Consistent with the Theory?

Current federal tax law maps onto this template closely, though imperfectly. First, it provides a relatively broad exemption for interest on bonds issued to fund projects that will have multijurisdictional effects, even where those projects might not otherwise qualify for the exemption because they constitute private activity bonds. Qualified private activity bonds that are eligible for the tax exemption tend to consist of projects, such as airports, docks, wharves, inter-urban rail facilities, solid waste disposal facilities, and public educational facilities, that have substantial effects beyond the jurisdiction of the nominal issuer. Thus, it is plausible to conclude that these projects would not have been undertaken, or would not have been undertaken to the same extent, without the federal subsidy.

In addition, federal tax law permits the tax exemption to be used to foster local conceptions of the ideal mix of public goods. For instance, if a locality truly believes that a sports stadium will provide it with a competitive advantage or enhance residents' sense of community, it may use the federal tax exemption to pursue that vision. But, and this is an important condition, federal tax law contains a variety of provisions that can properly be understood as imposing on a locality the obligation to ensure that the decision to undertake a project does, in fact, reflect the preferences of local residents. If it does not, if the project is undertaken solely to satisfy the interests of a relatively small group of constituents, then the project cannot readily be linked to fostering local autonomy. As a result, the federal interest in subsidizing the project is diluted. The availability of the tax exemption under those conditions looks more like an effort by which local officials can simply confer a significant benefit on

favored interests in the form of lower financing costs, and shift the lion's share of the subsidy to federal rather than to state and local taxpayers. From the perspective of local officials, this is a winning strategy. They can confer an advantage onto local interest groups, but externalize the related costs in a manner that saves them from having to increase taxes or charges on their constituents.

The result is that many of the conditions for the issuance of municipal bonds are linked to transparency and democratic accountability in the local decision-making process. Satisfaction of these conditions enhances the likelihood that local residents will monitor their political officials to ensure that the projects that are subsidized in the name of fostering local autonomy and generating significant spillovers will, indeed, have those effects. The need for these conditions is apparent from the literature on tax expenditures, i.e., losses to the public treasury that materialize as a result of deductions or credits, rather than from direct expenditures from funds that are paid into the treasury. Tax expenditures are more difficult to monitor because they fall outside the normal process of public appropriation and expenditure. Whereas a direct expenditure from the municipal budget, such as the local parks department budget, can be monitored with relative ease by looking at a particular line in the overall municipal budget, it is far more difficult to monitor tax expenditures, because they entail forgone income that, because it is never received, does not show up in the municipal budget.

This meshing of tax policy and support for transparency and democratic accountability is implicit in the requirements that issuers of bonds must satisfy in order to qualify for the federal tax exemption. To continue my example of the locally desired stadium, the locality may take advantage of the federal subsidy if it is willing to finance a stadium from municipal revenues that have been generated by the traditional taxing mechanism used by the city to fund the public goods and services that it provides – what are referred to in Treasury Department regulations as "generally applicable taxes." Although, or maybe because, we tend to complain about the taxes that we must pay, generally applicable taxation has a constraining effect on government and a beneficial effect on democratic governance. In order to ensure optimal taxation rates, constituents tend to monitor expenditures made by their officials with tax dollars. I am not suggesting that every taxpayer monitors the municipal budget. But there is a tendency for some groups or individuals with an intense interest in the expenditure process to ensure that tax dollars are not being spent in a manner inconsistent with the interests of constituents generally. When

generally applicable taxes are paid into a single revenue pool, such as a municipal treasury, and then appropriated through a process in which different claimants compete before a legislative body for a share of that pool, the outcome is more likely to reflect expenditures that constituents prefer.

Thus, the underlying assumption of extending the federal subsidy to bonds paid from generally applicable taxes is that if the project, even one like a stadium that may not fulfill a traditional governmental function, must compete for part of the municipal budget, and if those who pay the taxes and fees that are used for debt service support the project, as evidenced by their willingness to have their exactions dedicated to it as opposed to alternative projects or lower taxes, then there is a significant likelihood that the project is consistent with the ideal mix of goods and services that define local autonomy. The fact that governmental bonds are paid for from revenues that are appropriated through the normal budgetary process means that the decision to pursue and finance the project is relatively transparent and easily monitored by local constituents who have an incentive to monitor government expenditures. Of course, the issuer of the debt must still satisfy state constitutional and statutory requirements for localities. As a result, particular projects that confer significant benefits on private parties, such as a sports stadium, may run afoul of state constitutional limitations on the purpose of governmental borrowing. But those state constitutional limitations should be disaggregated from any inquiry into the proper scope of the tax exemption. The key point is that, by inducing states and localities to determine in a transparent manner which projects to undertake with revenue generated by their own generally applicable taxes, federal tax law significantly supports the kind of local autonomy that underlies our federalism.

Once we move away from state and local obligations that are supported by generally applicable taxes, it is notable that even qualified private activity bonds that are eligible for the tax exemption include requirements that enhance transparency and democratic accountability in the local decision making process. These requirements enhance the likelihood that both the project to be financed and the means of financing reflect constituent preferences. For instance, most forms of private activity bonds, even those that confer sufficient public benefits to warrant eligibility for the tax exemption, are subject to a volume cap imposed on jurisdictions.[1] This

[1] See 26 U.S.C. § 146.

requirement plays a role similar to the role in the case of governmental bonds of having a single pool of general revenue over which sponsors of particular projects must compete. Where private activity bonds are secured by private payments that do not flow into the general treasury, they will not be subject to the same competitive process with its attendant transparency and susceptibility to monitoring. The volume cap, however, can serve as an effective substitute for the benefits of the budgetary process by limiting the amount of inexpensive financing, thus creating competition for projects that are eligible for tax-exempt financing. Just as in the case of competition for funds from the general treasury, competition for an allocation of volume cap means that sponsors of potential projects will have to persuade local officials that their projects return more benefits than alternatives. Sponsors of competing projects have incentives to aggregate support for their proposals among local constituents. In short, the volume cap requirement increases the likelihood of debate about which proposed projects are most beneficial, a process that is consistent with ensuring that decisions reflect the interests of the community at large.

Finally, a private activity bond is not a qualified bond eligible for the federal exemption unless the bond satisfies a "public approval" requirement.[2] That requirement can be satisfied only if the governmental unit that issues the bond or on behalf of which the bond is issued approves the issue through its elected representatives after "a public hearing following reasonable public notice," or through a voter referendum. Note that what must be approved is the issue of the bond, not simply the underlying project. These conditions demonstrate that the objective of the public approval requirement is to facilitate public monitoring of the local decision making process concerning the financing of the project, and to ensure that projects that benefit from the federal tax exemption reflect local preferences, rather than one that serves a relatively small group that has disproportionate access to the local decision making process. What is also notable is that these requirements apply even where the bond is not payable from the issuer's generally applicable taxes and the locality's credit is not pledged to pay debt service.

III. The Role of PILOTs

How do payments in lieu of taxes, or PILOTs, fit into this scheme? The answer to that question affects the difficult inquiry into the conditions under which PILOTs should qualify as

[2] See 26 U.S.C. § 147(f).

"generally applicable taxes" rather than private payments, so that projects financed with PILOTs would escape the strictures of private activity bonds. The issue is difficult because PILOTs are a bit of a hybrid, with characteristics of both traditional taxes and traditional private payments. Treasury Department regulations describe a generally applicable tax as "an enforced contribution exacted pursuant to legislative authority in the exercise of the taxing power that is imposed and collected for the purpose of raising revenue to be used for governmental purposes." PILOTs arguably satisfy the definition insofar as they are substitutes for and are based on property taxes that constitute an enforced contribution. The 2006 proposed amendments to the regulations would clarify this view by requiring eligible PILOTs to be variable with the assessed value of the property in respect of which they are paid.

But to the extent that specific PILOT payments are dedicated to debt service for a particular project, those payments arguably have more in common with the kind of special charge, such as an assessment related to a particular municipal improvement, that the regulations exclude from "generally applicable taxes" used for general governmental purposes. The proposed amendments suggest something similar by excluding PILOTs that are based in any way on debt service for an issue. Even PILOTs that are not explicitly predicated on debt service, but the proceeds of which are dedicated to debt service of a particular improvement may have the characteristic of being "a payment for a special privilege granted or service rendered" that is not a generally applicable tax.[3]

In resolving this ambiguity about the proper characterization of PILOTs for purposes of the federal tax exemption, it is useful to consider the effects of those payments and to determine how those effects fit with the issues of transparency and democratic accountability that I have argued pervade generally applicable taxes and other features of the exemption. From this perspective, PILOTs appear to bear greater resemblance to the exactions that fall within the scope of private payments than to taxes.

As a purely economic matter PILOTs may be equivalent to other forms of subsidies for financing infrastructure or attracting tax base to a locality. A firm that is considering locating in a jurisdiction may be indifferent as between an arrangement that grants it a property tax abatement of 80 percent and an arrangement that requires it to make payments in lieu of taxes for

[3] 26 C.F.R. § 1.141.4(e)(3).

the use of land owned by the locality where those payments amount to 20 percent of the property taxes that would otherwise be payable. But from the perspective of the role of tax payments in inducing transparency and democratic accountability, these structures may differ dramatically. The reason for this lies in the way that PILOTs tend to be treated in the budgetary process. Assistant Secretary Treasury Solomon has correctly noted on multiple occasions that the federal tax exemption on bonds itself is less susceptible to monitoring because, unlike direct appropriations, its use is not tracked through the appropriations process.[4] Instead, as I suggested above, tax expenditures like the exemption suffer from a lack of transparency because they do not show up on governmental budget lines. While the unabated portion of property taxes still flow into the public treasury, PILOTs may lack the same transparency and susceptibility to monitoring. That is the case, at least, to the extent that they are treated in municipal budgets differently than taxes, are dedicated to particular payments rather than paid into the local treasury to be appropriated in the same manner as other expenditures, or are treated as contract revenues to be transferred or disposed of through a process that varies from and is less observable than appropriations from a fixed budget. For instance, the Mayor of New York City has taken the position that PILOTs constitute contractual rights that had been negotiated by the city rather than tax payments. As such, the Mayor's Office has claimed that PILOTs were not revenues of the City susceptible to payment into the general fund and control by the City Council; instead, they were assignable to City projects within the discretion of the Mayor. Similarly, the Ohio Supreme Court has declared that PILOTs are not taxes subject to voting requirements where the PILOT payments were made to an earmarked fund.[5]

Indeed, the difficulties related to monitoring the use of PILOTs are exacerbated to the extent that PILOTs are deemed generally applicable taxes, so that the bonds they secure qualify as governmental bonds rather than private activity bonds. Under those circumstances, failure to treat PILOTs in the same manner as tax revenues paid into and appropriated from the municipal treasury through the normal budgetary process means that the bonds that they secure will not be

[4] See Testimony of Treasury Assistant Secretary for Tax Policy Eric Solomon before the House Oversight Subcommittee on Domestic Policy on Tax Exempt Financing, October 10, 2007; Statement of Eric Solomon, Acting Deputy Assistant Secretary of Tax Policy, Hearing on the Use of Tax-Preferred Bond Financing before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, U.S. House of Representatives, March 16, 2006 at 11.

[5] City of Dayton v. Cloud, 285 N.E.2d 42 (Ohio 1972).

scrutinized through the monitoring process that typically applies to municipal revenues. On the other hand, because these bonds would not qualify as private activity bonds, they are not subject to the alternative means of assuring transparency and monitoring, such as volume cap and the public approval requirement. In short, at least to the extent that PILOTs are treated differently from taxes, they permit evasion of the kinds of democratic scrutiny that ensure that federally tax-exempt projects and financing structures reflect constituent preferences and serve the objectives of local autonomy.

None of this is to say that the use of PILOTs to finance local projects is illegitimate. If a state or locality believes that PILOTs return benefits in attracting tax base over and above the benefits that could be obtained from other forms of subsidies, such as property tax abatements, direct grants, or exemptions, that jurisdiction should be perfectly free to employ that structure. But nothing about the fact that PILOTs are useful from a local perspective requires that the federal government similarly embrace the concept or allow use of a federal subsidy to support it, notwithstanding that its use is inconsistent with federal interests. On the other hand, if a particular state or locality, such as my own, is disadvantaged relative to other states by virtue of state constitutional clauses that preclude the use of financing structures more amenable to federal subsidy, then the state or locality is perfectly free to alter those limitations in order to avail itself of the same benefits obtainable by others. Indeed, it is plausible that by disadvantaging opacity in public finance, federal tax law can provide useful incentives for the reform of anachronistic procedures in state and local finance.

My thanks for your time and attention. I would be pleased to answer any questions you might have.

Mr. KUCINICH. I thank you Professor Gillette.
Professor Humphreys, you may proceed. Thank you.

STATEMENT OF BRAD HUMPHREYS

Mr. HUMPHREYS. Thank you very much, Mr. Chairman and the rest of the committee members that are here.

The first point I want to address is to put this PILOT decision in a broader public policy perspective, and this addresses some of the points that were made by Assemblyman Brodsky just a moment ago.

When you look at the whole deal, at the bottom of it the idea was that the Yankees and the Mets were given this kind of special treatment because they threatened to leave New York. From an economic perspective, the important part about that is that the reason that is a credible threat is that major league baseball enjoys an explicit antitrust exemption granted by Congress. That, I think, is the root cause of this problem.

If you are going to look somewhere about addressing this problem, the antitrust exemption is the place to start, because that is why Congresswoman Watson doesn't have a National Football League team in her District for the last decade or more; it is because you have to get to the anti-trust exemption if you are going to reduce the leverage that teams have over State and local governments.

So another important part about this is that the Yankees have raised their prices significantly, and I want to address how significantly. Clearly, baseball teams charge a lot of different prices—$10, $12, $15—different price levels, and teams that move into new stadiums clearly raise their prices. But it is hard to assess how much they raise their prices by because of the many different prices they can raise.

The important part I think about the Yankees case is that at the top end their price increases are exceptional, a 600 percent increase in the price of the highest ticket that they are offering. That is off the scale compared to the last 30 years of price increases that we have seen in major league baseball when teams move into new stadiums.

At the average, it is also very, very large. It is four times the average increase of a team moving into a new stadium. That is a lot of price increases.

Now, the Yankees have claimed that they are holding the price of the bleacher tickets the same, and that is somehow good for the average fan. Well, what they have announced is that the full season ticket price of bleacher tickets is the same, so if you buy 81 tickets for the bleachers you can get them for $12. We don't know what the bleacher price is going to be for walk-up sales, which is what is appropriate for looking at the average baseball fan.

So those are exceptional price increases.

Next I want to talk about the effective consequences of this PILOT ruling for stadium financing. The Yankees get to build their stadium using tax-exempt bonds, which carry a lower interest rate. That reduces their interest cost.

The way the Congress intended the 1986 Tax Reform Act to work was if you are a State and local government you are going to fi-

nance your stadium through tax-exempt bonds. You must use general tax revenues to finance the principal and interest funds.

So State and local government, elected officials, are responsible to the taxpayers and voters by keeping the budget in line, and that provided a sort of Governor on the size of any spending on stadium projects.

Well, what effectively the PILOT decision does is it removes any of those sort of limits on spending on stadium projects because you would no longer have to worry about how the principal and interest payments are going to fit into your budget if you are a State and local politician. You got the money from the Yankees, so issue all the debt you want and let the Yankees build the largest and the most expensive stadium ever built in the history of major league baseball.

Look at what happened to the Nationals just a few years ago. Their stadium cost about $600 million. The Yankees' Stadium is costing twice that.

What is one of the reasons that it is costing twice that? Well, because they get issued these tax-exempt bonds.

Finally If you look at the documentation surrounding the whole PILOT decision, again and again we see that one of the rationales for granting the Yankees this benefit was the economic benefits that are going to be generated to the community from the new stadium. The primary issue there is all these construction jobs that are generated building this new stadium.

Well, there is a tremendous amount of scholarly evidence and peer reviewed academic journals that says there are such new benefits associated with stadium construction projects. Just because you look at the new stadium being built in New York and see a lot of construction jobs there, that doesn't mean that those condition jobs are new economic benefit to the community. In fact, the evidence is that it is not. Those are just construction jobs that would have been undertaken somewhere else in New York that didn't get built because of the Yankee Stadium.

So we can't conclude, just because there is a couple of thousand construction jobs created to build the stadium, that is really new benefit to the community.

So, in summary, I would say that the important point of the hearing is: let's don't have special benefits given to the Yankees. I would say there is a larger public policy issue here: let's don't have special benefits given to major league baseball in the form of an explicit anti-trust exemption, but let's examine both issues.

Thank you. I will take your questions now.

[The prepared statement of Mr. Humphreys follows:]

Testimony
Of
Brad R. Humphreys
Associate Professor
Department of Economics
University of Alberta

Domestic Policy Subcommittee
Oversight and Government Reform Committee

"Subsidization of Professional Sports Facility Construction"
Thursday, September 18th, 2008
2154 Rayburn House Office Building
10:00 a.m.

Chairman Kucinich, Ranking Member Issa and other members of the subcommittee:

In 2006, the Internal Revenue Service issued two Private Letter Rulings that enabled the New Yankees Stadium construction project in New York City to be financed by a tax exempt bond offering backed by payments in lieu of taxes (PILOTS). This ruling effectively allowed the Yankees access to low interest tax exempt bonds, as opposed to privately issued taxable bonds that carry a higher interest rate, to finance the construction of a privately owned sports facility. This ruling opened the floodgates to a subsequent wave of PILOT backed tax exempt bonds for the construction of new sports facilities that shows no signs of slowing. The Yankee PILOT decision raises several important economic policy issues that must be addressed if the Congress is to make and enforce appropriate economic policy about the financing of professional sports facilities.

MLB's Anti-Trust Exemption, Franchise Moves, and Public Subsidies

Before focusing on the details of the PILOT issue, I want to put the general topic of public financing of professional baseball stadiums into the broader context of federal government policy toward the professional sports industry in the United States. In particular, I want to draw attention to the fact that the financing of both new baseball stadiums in New York City was influenced by threats made by both the New York Yankees and New York Mets to leave the city of New York. In a memorandum from Andrew M. Alper to New York City Mayor Michael Bloomberg explaining why the Yankees were granted an exemption from the New York City Industrial Development Agency (NYCIDA) policy, then director Alper stated that failure to give the Yankees what they wanted would "result in the New York Yankees relocating the Team to a stadium outside the

City."[1] In another memorandum from Alper to New York City Mayor Michael Bloomberg explaining why the Mets were granted a similar exemption from the NYCIDA policy, Alper stated that failure to give the Mets what they wanted would "result in the New York Mets relocating the Team to a stadium outside the City of New York." [2]

Based on two memorandums from the NYCIDA, both professional baseball teams in New York City used the threat of leaving to extract concessions from the City of New York. Economic theory provides a clear explanation for why professional baseball teams have this power: they have significant market power and can operate as unregulated monopolies. Unlike most other industries in the United States, Major League Baseball (MLB) receives special treatment under federal anti-trust law. This special treatment has been extended by the Congress of the United States. In practice, the anti-trust exemption granted to MLB by Congress means that there are fewer MLB franchises than would exist if MLB were not granted this special status. Economic theory predicts that monopolies restrict output in order to realize monopoly rents. In the case of MLB, monopoly power is exercised by limiting the total number of teams in each league. In this specific case, it means that the Yankees and Mets were able to force state and local governments to grant them special benefits not available to other firms because of the anti-trust exemption granted by Congress . If MLB did not have this special protection, it is possible that the Yankees and Mets would not have had another viable alternative market to threaten to move into. The explicit justification for the deviation granted to both the Yankees and Mets stadiums was a threat to move. The ultimate cause of the New York PILOT mess is MLB's anti-trust exemption.

The Relationship between Ticket Prices and New Facilities in MLB

Major League Baseball teams produce a product that has only a few imperfect substitutes in the local economy. Unlike many other firms, MLB teams face little competition in the marketplace. This gives MLB teams significant latitude when setting prices. In most cases, when firms set their prices at a level "that the market will bear" they face significant price competition from other firms that limits their ability to raise prices. A business with many competitors cannot raise prices too much because their customers will turn to other producers. MLB teams do not face this type of competition. Their product has few close substitutes, so they can set prices based only on the market demand for their product. In large markets, like New York City, this market demand can be quite large compared to the number of tickets sold in any season. The only constraint on price increases faced by professional sports teams is the willingness of fans to pay in sufficient numbers.

Professional baseball teams offer tickets for sale at a wide variety of prices. Although the cost of attending a MLB game is often expressed in terms of an "average" or "median" ticket price, this simplification abstracts from actual choices facing consumers. An examination of the pricing policies of MLB teams from 1975 through 2006 reveals that, on average, MLB teams offered tickets at about six different price levels, with a maximum of fifteen different ticket price levels offered by a single team. In part, these differences in ticket prices reflect differences in the experience of fans:

[1] New York City Industrial Development Agency memorandum "Deviation from Uniform Tax Exemption Policy for Yankees Ballpark Company."
[2] New York City Industrial Development Agency memorandum "Deviation from Uniform Tax Exemption Policy for Queens Ballpark. L.L.C.."

a fan sitting in the first row behind home plate experiences the game in a different way that a fan sitting in the last row of the upper deck. Fans are willing to pay more for the experience of sitting in the first row behind home plate than they are for the experience of sitting in the last row of the upper deck. The large number of different prices offered by MLB teams means that they have many options available to them when changing prices. It also means that changes in the average or median price of a ticket may not reflect changes in ticket prices across the board.

Over the period 1975-2006, the average annual increase in the average ticket price charged by MLB teams playing in the same stadium as the previous season was 7.72%. The average annual increase in the median ticket price was 7.60%, a similar change. Because MLB teams offer tickets at many different prices, the change in the average or median ticket price may not reflect the overall pattern of ticket price changes from year to year. An alternative way of looking at price changes is to examine how the highest priced tickets and lowest priced tickets change. The average annual increase in the highest priced ticket offered by MLB teams playing in the same stadium over the period 1975-2006 was 9.17%. The average annual increase in the lowest priced ticket offered by MLB teams over this period was 9.27%. Teams playing in existing stadiums tend to raise the price of tickets at the upper and lower end of the price range more than tickets in the middle of this range. These annual price increases are not adjusted for inflation, for reasons that will be explained shortly. All of the relative price increases discussed here would be unchanged if corrected for increases in the overall price level.

MLB teams playing in new stadiums have, on average, increased their prices at a higher annual rate than teams playing in an existing stadium. The average annual increase in the average ticket price charged by an MLB team playing in a new stadium over the period 1975-2006 was 19.56%; the average increase in the median ticket price was 14.32%. There were 16 new baseball stadiums opened during this period. In part, these ticket price increases reflect a different experience for fans in a new stadium, but they also depend on the market power of MLB teams. The increases at the top and bottom of the price range charged by MLB teams differed from the changes in the average or median prices. The average annual increase in the highest ticket price offered by MLB teams playing in a new stadium was 32.23%. The average increase in the lowest priced ticket offered was 8.70%. High end tickets tend to see the biggest price increases when a team moves into a new stadium in MLB.

The increase in ticket prices announced by the New York Yankees in their new stadium has drawn a great deal of attention. The MLB wide averages reported above provide some perspective on the Yankees' announced price increases. In the 2008 season, the Yankees offered season tickets at 15 different prices, ranging from $12 per game for a full season ticket in the bleachers to $325 per game for a full season ticket in the "Field Championship" section. The average price of a season ticket to the Yankees was $106, and the median price was $70. The price of Yankees' season tickets in the new stadium in 2009 will range from $2500 per game for a full season ticket in the "legends" section to $12 per game for a full season ticket in the bleachers.[3] This represents a 139% annual change in the average price of a Yankees ticket, and a stunning 669% annual increase in the price of the highest ticket price offered. No MLB team moving into a new stadium has increased the top ticket price offered by this amount in the past 33 years. This 669% increase is 20 times larger than the average annual increase in the highest ticket price offered by MLB teams moving

[3] *Relocation Program Guide for the New Yankee Stadium*, Yankees.mlb.com.

into a new stadium, and more than three times larger than the next largest annual increase in the highest ticket price offered (the Detroit Tigers increased their highest ticket price by 200% when they moved into their new stadium in 2000.)[4]

The average increase in the median price of a Yankees ticket from 2008 to 2009 was 7%, and the per game price of a season ticket for the bleachers remains unchanged at $12 per game in the new stadium. Although the team has heralded this as evidence that the "average fan" would not be priced out of the new stadium, at this time the price of game day bleacher tickets has not been announced, only full season ticket prices. While there has been no change in the per game price paid by fans who purchase 81 bleacher tickets in advance, it remains to be seen how much a game day bleacher ticket (a better indicator of how much the "average fan" will have to pay) will cost in the new stadium.

How PILOTs Differ from other Stadium Financing Schemes

The PILOT decision has resulted in a financing deal for the new Yankee Stadium that differs in important ways from the way that other new professional sports facilities have been financed in the post 1986 Tax Reform Act era. Two examples make these differences clear. Nationals Park opened in Washington, DC on May 4th 2006. The stadium cost $610 million and was financed through the sale of tax exempt bonds issued by the city of Washington. Because tax exempt bonds were used to finance this stadium, the DC government had to raise taxes in order to pay the principal and interest on these bonds; these payments must come out of general tax revenues to comply with the Tax Reform Act of 1986. The requirement that the principal and interest on tax exempt bonds used to finance professional sports facility construction represents an important limit on the use of tax exempt bonds for this purpose, as well as a limit on construction costs. Local politicians are held accountable for the condition of their budgets by voters, and paying the principal and interest on these bonds out of general tax revenues has budgetary effects. Because general tax revenues are collected from a broader group of local residents than the sports fans that enjoy the benefits of a new stadium, this requirement reduces the amount of money spent on new sports facilities financed using tax exempt bonds, and may reduce construction costs as well.

AT&T Park, home of the San Francisco Giants, opened on March 31st, 2000. The stadium cost $357 million to build ($426 million in 2007 dollars) and was privately financed. No tax exempt bonds were issued to pay for the facility construction. The team had to pay a higher interest rate on the borrowed money than they would have if they had access to tax exempt financing, making the construction project more costly. The annual increase in the average price of a ticket offered by the Giants in 2000 was 21.3%; the annual increase in the highest priced ticket offered by the Giants was 9.52%, and the increase in the lowest price ticket offered was 66.6%.

Clearly, the PILOT decision has had a profound effect on the Yankee Stadium construction project. The access to lower interest rates offered by tax exempt funding, coupled with the lack of budgetary-related limits on costs combine to produce the most expensive stadium construction project in the history of Major League Baseball. And in part because of the lavish nature of the new stadium, the Yankees are able to pass on extraordinary ticket price increases to their fans.

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[4] Note that I compare the increase in the nominal price of Yankees tickets to the increase in the nominal price of other tickets because we do not yet know what the inflation rate will be between now and April 2009.

The Fallacy of New Job Creation in Sports Facility Construction

In reviewing documents related to the PILOT decision, one clear theme emerges: the primary economic rationale for the decision was that the new Yankee Stadium would be a significant engine of economic growth in New York City, and that this alleged economic benefit was sufficient justification for granting this exceptional privilege. In particular, the supporting documents point again and again to job creation associated with both the construction of the new stadium and the ongoing operation of the stadium as the primary justification for the decision.

These claims of significant economic benefits from sports stadium construction and operation are problematic for several reasons. First, they are forecasts, and not actual counts of jobs created or income earned. In the PILOT issue, and every other sports facility construction project I have studied, these forecasts of economic benefits are treated as factual assessments, rather than the forecasts that they are. Forecasts are not useful unless they contain a measure of the uncertainty associated with them, and the claimed future economic benefits from the new Yankee Stadium are never placed in this context. This makes them useless for informing economic policy decisions. The problem has already surfaced in the Yankee Stadium PILOT decision, as the claims of thousands of full time jobs made at the time the exemption was granted has already proven to be wildly overstated. Any additional claims of future economic benefits from the project should be taken with a grain of salt.

Second, there is no evidence in the large body of peer reviewed scholarly research on the economic impact of professional sports facilities that indicates any professional sports facility construction project, or the ongoing operation of any such facility has generated any tangible economic benefits in the local economy.[5] In fact, economists widely agree on this point, and it is backed up by decades of evidence based on peer reviewed research. Even if the New Yankee Stadium is the most expensive stadium construction project in history, it will likely not generate any significant economic benefits in New York City.

Claimed benefits from the construction jobs created during stadium construction projects are one of the most abused claims of tangible economic benefits made by those seeking subsidies, because they are so evident. One has to simply drive by the construction site and see it swarming with workers to confirm these claims of economic benefits in the community. However, there is more to this situation than meets the eye. The key to determining the actual net economic benefits generated by sports stadium construction projects is to determine how many jobs are created that would not have existed if the project did not take place, and also to determine how many of the workers filling those jobs would have been unemployed if the project had not taken place. According to economic theory, only this small subset of the total number of jobs created by a stadium construction project can be counted as part of the economic impact of the project. Calculating this number cannot be accomplished by a simple inspection of the construction sight, and assuming that every worker observed on the job site represents new economic benefit to the local economy is erroneous.

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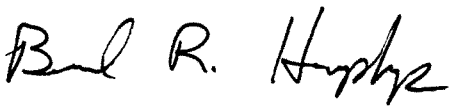
[5] See Dennis Coates and Brad R. Humphreys, "Do Economists Reach a Conclusion on Subsidies for Sports Franchises, Stadiums, and Mega-Events?" *Econ Journal Watch*, vol. 5, no. 3 (September 2008), pp. 294-315 for recent evidence on this point.

The net economic benefit created by stadium construction projects is much smaller than the total economic benefit (which can be easily found by simply adding up the total amount of spending associated with the project) because of the presence of opportunity costs, and the double counting that typically takes place when non-economists attempt to estimate these benefits. Opportunity cost is the cost of forgone alternatives. In the case of the New Yankee Stadium, the facility generates significant opportunity costs for the City of New York and in the local community. The City could have issues a billion plus dollars of tax exempt bonds to finance any number of alternatives. The testimony of Seth Pinsky, president of the NYCIDA before the New York State Assembly on July 2nd of this year indicates that his agency receives hundreds of requests each year for public tax exempt funding for construction projects.[6] The materials and supplies that are going into the construction of the new stadium could have been used on other construction projects. And most importantly, the construction workers employed on this project could have worked on other project. Economic theory tells us that only those construction workers who would not have had a job if the stadium was not built can be counted as net economic benefit from the project. According to a recent Bureau of Labor Statistics press release, the unemployment rate for construction workers in August 2008 was 1.9%.[7] This low unemployment rate means that the actual number of new construction jobs created by the New Yankee Stadium project was a tiny fraction of the total number of jobs created by the project.

Thank you for your time. I will now take your questions.



Brad R. Humphreys
Associate Professor of Economics
University of Alberta

[6] Transcript from July 2nd 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City, hearing before the Assembly Standing Committee on Corporations, Authorities and Commissions.
[7] http://www.bls.gov/news.release/empsit.t11.htm

Mr. KUCINICH. Thank you, Professor Humphreys.

I would like to start with Assemblyman Brodsky. It is clear from your report that you believe the city's sole rationale for deviating from the State's uniform tax exemption policy was the threat that, absent public financing, the Yankees would depart New York City. It is also clear you don't believe that the city has provided any real evidence of the Yankees actually making such a threat to the city.

On the other hand, you acknowledge the Yankees operate as a virtual monopoly under antitrust laws. Many economists have pointed to this status as a key to understanding why sports franchises extract such lucrative deals from cities.

Is it possible, Assemblyman, that even if the Yankees never made an explicit threat to the city, it was an ever-present backdrop to the negotiations with the city for a stadium deal?

Mr. BRODSKY. Mr. Chairman, let me, if I may, mildly correct the question. This report has nothing in it about my beliefs. What this report has is evidence adduced after review of documents. I would like to share with you my beliefs, but that is not what is in the report.

In the report there is evidence that the city stated as a matter of law that the sole reason for giving the benefits was the threat to leave, so that whatever the policy questions are, that was stated as the reason.

The evidence we uncovered shows that such a threat was not made, and when asked under oath, the head of the IDA sort of conceded that he didn't know if, when, and how such a threat was made.

To the extent that it was in the ether, in the background, and was something that the city had to sort of be worried about without an explicit threat, it seems to me that when you are negotiating a billion dollars worth of goodies you ought to have more than the other.

Second of all, for that to be a real threat there had to be a place for them to go. Given the timing of this deal, if they were going to leave were they going to go to Jersey? They had said publicly they would not do that.

So the evidentiary basis for what we uncovered is that there was no such threat, and that if it had been made it was not credible.

Well, we are playing chicken a little bit here because no leader of the city of New York wants to be the public person responsible for losing the Yankees, and in that case I would simply suggest that there was a public process to test it. They had an obligation to tell the truth and they did not.

Mr. KUCINICH. Professor Humphreys, would you comment on that, because this is in line with your testimony?

Mr. HUMPHREYS. Yes. I would love to.

I think that, whether or not somebody would testify under oath that there was a threat made, the threat is always there. Because the League operates as a monopoly, we know from economic theory that monopolists reduce output in order to extract monopoly rent. In this context, reducing output means that they have fewer teams than they would if we didn't have the antitrust exemption, so that means that there are viable markets open somewhere.

I will point out that in the 1970's when Yankee Stadium was being renovated, I believe the Yankees played a whole season outside of Yankee Stadium in Connecticut. Just because they said they weren't moving to New Jersey doesn't mean that they were——

Mr. BRODSKY. Shea.

Mr. HUMPHREYS. Was it in Shea? But just because they said they wouldn't move to New Jersey, that doesn't mean that there was not other viable markets that they could move into. So I think it is a credible threat, even if it is implicit.

Mr. KUCINICH. Professor Gillette, when the Industrial Development Agency and the city decided to issue $900 million worth of bonds for the Yankee Stadium project, or an additional $360 million of bonds to complete the project, what is the full range of potential cost, economic and otherwise, facing the city?

Mr. GILLETTE. I'm sorry. Let me make sure I understand your question, Mr. Chairman. What are the implications?

Mr. KUCINICH. Let's suppose that we conclude that the assessment of Yankee Stadium was improperly inflated by New York City and, in fact, the stadium is not worth $1.2 billion, but is closer to $900 million. Can you explain the possible consequences if this were established, including economic consequences for the city and the bondholders and the potential legal liability for other parties in the bond offering?

Mr. GILLETTE. Certainly.

Mr. KUCINICH. And after you conclude, I would like Mr. Brodsky to comment on this, as well.

Mr. GILLETTE. Then I think that, again, when we are speaking hypothetically, but there could be extraordinarily serious consequences for the city of New York.

First of all, I take under circumstances Mr. Larson said today if it turns out that the representations were inaccurate than the PLR would not necessarily be effective, and the Internal Revenue Service would have the ability to declare those bonds taxable.

If those bonds were, in fact, taxable, then bondholders who purchased them on the belief that the interest they received was tax exempt are going to be, shall I say, mildly upset. Either the city will have to step up and pay to the IRS the lost revenue to the Federal Government, which I believe you classified this morning as somewhere around $200 million. The city would have to step up to that to avoid the imposing of additional tax liability on the bondholders. Or, if the bondholders do face that liability, one would assume that they are going to make claims against the city.

If, in fact, what you are suggesting is that there may have been some knowing misrepresentations, then I take it the city, along with other participants in the bond process—but you asked primarily about the city—would be subject to liability under the antifraud provisions of the 1934 Securities Act. I am not a securities lawyer, but my understanding certainly is that a municipal corporation is a person for purposes of section 10(b) of the 1934 Securities Act and for purposes of liability under that provision.

Mr. KUCINICH. You know, as we go to Assemblyman Brodsky for a response, and then we will go to Mr. Cummings after Mr. Brodsky replies, this question I think is properly framed through

your testimony of the wildly disparate price per square foot of the land.

You testified that on the one hand the land was assessed at $275 per square foot, and on the other hand the second appraisal by the Park Service was——

Mr. BRODSKY. The gross numbers are easier.

Mr. KUCINICH. Twenty-one.

Mr. BRODSKY. It is $21 million versus $204 million.

Mr. KUCINICH. So, in light of what Professor Gillette said, what are the implications here?

Mr. BRODSKY. Well, the implications, first, as Professor Gillette said, has to do with the telling of truth in both the State process and the Federal process. It would have an implication for the National Park Service and the State law requirement for replacement of park land. But the most profound effect would be as to whether or not the revenues generated from the PILOTs would be sufficient to pay the debt service on the tax-exempt or taxable bonds.

Assume you needed $50 million a year in debt service, at the new assessed value the PILOTs would only generate $35 million. You have a $15 million shortfall with respect to payment of debt service.

Mr. KUCINICH. And who would have to make that up?

Mr. BRODSKY. That would be a matter for the courts to determine as between a series of wronged persons. The interesting question here is what constitutes the violation of a promise to the IRS. As was cited in the report in my testimony, the city specifically said that it would assess the property as would any other property of the city be assessed. That did not happen.

The consequences of that are first a matter for the IRS. I admire the unwillingness of the IRS to comment publicly on a specific taxpayer's issues. That is the correct policy. Having said that, I don't know what it takes to get their attention. I think that is going to come out in the wash as the IRS reviews, apparently, the newspaper reports.

Mr. KUCINICH. I want to thank the gentlemen.

We are going to go to a second round of questioning, but I want to defer now to my colleague, Mr. Cummings, for questions.

Thank you, Mr. Cummings.

Mr. CUMMINGS. First of all, I want to thank all of you for your testimony.

Assemblyman Brodsky, in Baltimore when we built the stadiums, we built two stadiums almost simultaneously, the Ravens and the Orioles, but when Orioles Stadium came around there was this belief that what you said, there was a lot of competition in other places and that we might lose the Orioles. It was a genuine concern.

I am trying to figure out, you seem to think that was a key in all of this; is that right? In other words, that possibly you might lose?

Mr. BRODSKY. No, my view is what we did was we established that was the legal reason the city of New York gave, even though it could not substantiate it.

Mr. CUMMINGS. I got you. And so you don't believe that to be true?

Mr. BRODSKY. I don't know, but I do know that the obligation of the public officials in charge of the public fisc is to check it out. I do know that Mr. Steinbrenner had at some point said they would not leave. Whether they would leave and the New York Mets would leave and there would be no sports teams in New York, I believe that would be a political impossibility and I believe this is a political question, as well.

Mr. CUMMINGS. Probably would go crazy.

Mr. BRODSKY. You know, we are just a few country lawyers up there, but we know enough to protect the interest of our people, and there are condemnation remedies if someone tries to take a partnership out of the city or the State. There are lots of things to do. We shouldn't have to get there. In the end, my only point is that, although the law requires public economic benefits in exchange for public subsidies, that did not happen, and the mere conjecture about leaving is not enough as a matter of policy or of law to justify a billion dollars of public money.

Mr. CUMMINGS. It seems as if people rally around. I remember when we were dealing with the Baltimore deal, the Orioles, I swear, I was trying to figure out what benefit was coming to the city. I mean, I couldn't figure it out. It seemed like everything was going to the owners, so I kind of concluded that this was a rah-rah kind of thing. In other words, let's do it for the good of the city; that is, having a cohesive element.

You know, there is not a lot to bring people together, but teams seem to be able to do that. It was attractive for tourists, maybe, when they come in. Maybe. I see you shaking your head. Why are you shaking your head?

Mr. HUMPHREYS. I lived in Baltimore for 17 years.

Mr. CUMMINGS. Good. So you know what I am talking about.

Mr. HUMPHREYS. I do exactly. Yes. Your point is exactly right. The benefit is all intangible, according to the research evidence. It is a sense of community, and it allows people like me and you to bond about the Orioles or something like that.

Mr. CUMMINGS. Right.

Mr. HUMPHREYS. Which other things in society can't do.

Mr. CUMMINGS. Right.

Mr. HUMPHREYS. The tangible economic benefits associated with tourism are not there, even if they are claimed. So I think you are exactly right about where the benefits are.

Mr. BRODSKY. If I may, Congressman, there is nothing like professional sports to make public people nutty.

Mr. CUMMINGS. To make public people what?

Mr. BRODSKY. Nutty.

Mr. CUMMINGS. OK.

Mr. BRODSKY. If you will recall the introduction by Justice Blackman in his decision on the Curt Flood case, unlike any case I have ever read, the entire first portion is a recitation of who his favorite baseball players are. Now, this was a distinguished jurist and a figure of national legal repute. When you start talking about sports in the context of government, you have finally found something that we as public officials don't have to force on the public and say be interested. They care.

Mr. CUMMINGS. Yes.

Mr. BRODSKY. That level, I think, of political and voter interest makes us do things we would do for no other enterprise in our society.

Mr. CUMMINGS. Are you all of the opinion that there should not be this kind of tax favoritism when it comes to teams?

Mr. BRODSKY. Yes.

Mr. CUMMINGS. All of you? I mean, do you see any reason why we should have this type of situation where folk can take advantage of this tax exemption?

Mr. GILLETTE. Congressman, I want to be a little more reluctant than my colleagues on the dais up here and say it depends on who the we is. That is, if a particular municipality or municipal officials going through a process that reflects the true preferences of their constituents decides that, the absence of economic benefits notwithstanding, the kinds of more ephemeral benefits that Assemblyman Brodsky and Professor Humphreys are referring to, warrant a particular use of public money, then I, a fan of local autonomy, say that is just fine. But that public money should be the municipalities' public money if it is a municipal decision.

So if we mean by we is the municipality actually internalizing all the economic effects of its decision, I have less difficulty, even though I might disagree.

What I do disagree with is the notion that simply because a municipality says we believe, as local residents, that this is in our local interest, that necessarily entails the use of a Federal tax exemption so that non-residents of that municipality are required to subsidize the local decision.

Again, I am a huge fan of local autonomy. I think for that reason it is appropriate for the Federal tax exemption to be available in many cases to foster local decisions, but I see nothing in our federalism, certainly nothing Constitutionally that says that, simply because a locality has decided to pursue a particular project, it has a call on the Federal Treasury as well as the municipal treasury.

Mr. CUMMINGS. Yes.

Mr. BRODSKY. What he said.

Mr. HUMPHREYS. And I think that your question, sir, is: should we allow tax-exempt bonds to be used to finance these projects. Now, that means that there is a subsidy coming from every U.S. taxpayer, and I think that is inappropriate, because you are asking the entire country to subsidize the individual preferences of whatever the municipality is to build their palace of a sports stadium. That is bad policy, any way you look at it.

As Professor Gillette has pointed out, it should be the locals who should pay, because they are the ones that are getting the benefit from it. So if we are talking about Federal tax dollars, I don't see any justification for it whatsoever.

Mr. CUMMINGS. I guess the other thing, as I close, Professor Gillette, you have to have, even in the scenario you just gave, there is something called integrity that you have to have there. I think sometimes there is some smoke being blown all over the place, and when the smoke clears maybe, just maybe, the folks are believing that there may be some benefit other than the rah-rah effect, and what you all are saying is rarely—and I am just curious.

Do you know of any situations where you think it was appropriate? In other words, where there was integrity with regard to what the taxpayers were getting out of it, and that—because I noticed a lot of promises are made up front, and then after a while you don't see a thing. Sometimes you see a loss. So I'm just wondering, do you all see any situations now that exist in your research?

Mr. BRODSKY. Well, in my earlier direct testimony, Congressman, I did point out that New York exports revenues to the Federal Government to the tune of about $80 billion a year.

Mr. CUMMINGS. Right. I heard that.

Mr. BRODSKY. And there is an argument that says anything that keeps the money back in New York is a good thing. So to the extent we exclude the context, the revenue export context, and ask the simple question you asked, which is, is there any benefit that you see from these public expenditures, my answer is no, I do not.

Mr. HUMPHREYS. I think there have been instances where taxpayers got their fair share. Those have been these instances where there was a referendum, it was on an increase in local taxes to pay for stadium improvements. They passed that referendum and they used the money. Green Bay is a classic example of this. The residents of Green Bay voted themselves a tax increase that was about $1,000 a year in order to renovate Lambeau Field. I think that is a clear expression of local interest, and they were willing to pay through higher taxes, and they got a renovated Lambeau Field.

Those instances are few and far between, though.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Mr. GILLETTE. May I just add? I would agree. I think, Congressman, that the way to ensure what you are referring to as integrity is through physical transparency at the local level, so that if what are being used are taxes that go through the normal budgetary appropriations process of the municipality, as Professor Humphreys referred to, there I think you have the greatest likelihood that the expenditure is going to be monitored by local residents to ensure that the expenditure is made in a manner consistent with local preferences.

The problem with PILOTs is they are not necessarily funneled through that appropriations process. They may, as in the case of Yankee Stadium, be treated as off-budget, essentially tax expenditures, where they are far less susceptible to monitoring, and therefore it is by no means clear that the expenditure reflects what residents really want done with tax dollars or with the opportunity cost for tax dollars.

Mr. KUCINICH. I think, Professor Gillette, when you talk about transparency—Assemblyman Brodsky, maybe you can shed some light on this—do you know, in your inquiry, how the New York City Department of Finance came up with the $275 per square foot amount and who actually did the assessment?

Mr. BRODSKY. Yes. We met, after reviewing documents, directly with Department of Finance personnel. The seven elements of this assessment are listed in my direct testimony. Without going over all of those, when we raised with them the question of why they didn't take comparables in the Bronx, why they took them in Manhattan, when we raised with them the failure to adjust for lot size

and location, they literally fell silent. I mean, I would say, Well, why did you not do that, and they literally sat there.

There is a substantial question about the manipulation of land assessments on the New York City assessment roles that this issue illuminates. There is a related development right near the stadium called the Bronx Terminal Market. It is being done by a very large and powerful developer in New York City who has an interest in a lower per square foot land value. That land value was calculated, two blocks from the stadium, at $9 a square foot. Where there was a city interest in a higher per foot value, again, just the land, the city assessed it at $275.

Mr. KUCINICH. I am going to go back to questioning Professor Gillette, but what my colleague, Ms. Watson, said earlier, you look at what is going on and the turmoil that is hitting Wall Street right now, which at the center of it is that the value of securities and securitized instruments was grossly inflated. This is what the whole subprime lending thing is about. And so it appears from your testimony, Assemblyman Brodsky, as you state, there are much broader questions reflected here, although in this particular case the disparity between $275 per square foot and $45 per square foot requires this subcommittee to not rest until the silence is broken. So I thank you.

I want to ask Professor Gillette, New York City and New York State have argued that the Treasury Department's proposal to revise the PILOT rule unfairly discriminates against the city and State because it effectively prohibits the use of PILOTs, the one financing mechanism available for New York to finance tax-exempt bonds in New York. First, can you explain why, as you understand it, New York cannot finance tax-exempt bonds in the same manner as the District of Columbia, that is, from the proceeds of a tax imposed on its citizens specifically to finance stadium bonds?

Mr. GILLETTE. My understanding is that New York State has a Constitutional provision that requires all local debt essentially to be what is called faith and credit or general obligation debt, so that New York City cannot funnel off particular revenues and dedicate them to a bonded project.

Other States do not have this kind of limitation, and therefore have greater flexibility with respect to their financing opportunities.

Mr. KUCINICH. So what is your reaction to this argument that the Federal Government should design its regulations to take into account particular features of New York laws? Do you think that this is a sound principle routed in federalism?

Mr. GILLETTE. My guess is federalism actually cuts just the other way. I mean, federalism suggests that States ought to have opportunities to design their governmental structures any way they want. We don't need cookie cutter State Constitutions. Different States can experiment with different restrictions and different allowances for their State governments.

But what federalism entails is you have to take the good with the bad. If you want the opportunity to fashion your governmental structures in a way that is free of control of Federal Government, then every once in a while you may be disadvantaged by that governmental structure.

If New York State or the residents of New York State were to determine that, in fact, the disadvantage of not being able to utilize certain Federal opportunities or federally created opportunities was so great, then New York State, the good residents of New York State have the opportunity to amend the Constitution, which is exactly what they have done in the past, for instance, with respect to allowances for what is called tax increment financing, TIF financing, which my understanding is I believe would not have been allowed but for a particular Constitutional amendment.

Mr. KUCINICH. Well, Professor, you have heard the IRS testify here today that the fact that a State treats PILOTS for certain purposes as if they are not taxes would be a legitimate consideration whether the IRS views the PILOT as a generally applicable tax. Are you aware of any way in which New York law treats the type of PILOTS used in the Yankee and Mets deals as non-tax revenues?

Mr. GILLETTE. As non-tax?

Mr. KUCINICH. Right.

Mr. GILLETTE. It is not clear to me how New York State treats these PILOTs. It certainly seems that the Office of the Mayor has made a claim that they are not tax revenues and therefore can be expended through a process other than the normal process that would apply to, for instance, property taxes.

Mr. KUCINICH. Thank you.

Professor Humphreys, how do you respond to the argument that demand is the ultimate check on a team hiking ticket prices? Under one version of this theory, because the new stadium is roughly the same size as the old one, the supply has remained the same. Thus, the only way the team could raise ticket prices is to capture increased demand for the enhanced experience at the new stadium. What is wrong with this analysis?

Mr. HUMPHREYS. Well, the consumer's willingness to pay is ultimately the cap or the limit on what the Yankees are able to charge for tickets. Right? So there is some truth in that statement that the demand does limit this. But the Yankees are not competing with anybody.

Mr. KUCINICH. Well, should we care if the Yankees raise ticket prices exponentially for good seats if there is still a sizable minority of affordable seats available for less-wealthy fans or if the games are still available on TV?

Mr. HUMPHREYS. Well, I think we should. I think we should because of the consumer surplus that is out there. Right? So there are many, many fans——

Mr. KUCINICH. Do you want to elaborate on that?

Mr. HUMPHREYS. Sure. Think about some of your constituents who are Cleveland Browns fans and they buy Browns tickets and they pay whatever the value is of those tickets, but their value that they place on the experience probably is much higher probably than what they have to pay because of the place the Browns hold in the community. Right? So there is a tremendous amount of consumer surplus that gets generated by professional sports. That is enjoyment that you don't have to pay for.

So the Yankees are able to capture a lot of that consumer surplus—that is the internalized benefit that people get from that—

by raising their prices for what is essentially the same product. It is watching a Yankees game. That reduces welfare to consumers, the sort of total benefit that consumers get from consuming this product. So that makes the community worse off if a private enterprise like the Yankees is able to capture more of that consumer surplus through the act of changing prices. So it has economic consequences, and they are important.

Mr. KUCINICH. You testified as to the amount of the ticket price increases. Did you quantify that?

Mr. HUMPHREYS. Yes, I did.

Mr. KUCINICH. Can you again? Let's talk in terms that fans relate to.

Mr. HUMPHREYS. Sure. The average price increase of a baseball team that moved into a new stadium over the last 30 years was about 20 percent. Right? The Yankees' average price increase is 139 percent, so it is many, many times. Baseball fans would expect to pay higher ticket prices when a team moves into a new stadium, but that is an extraordinary increase, well above—you have to look very hard to find any evidence of a team moving into a new stadium that increased prices by anywhere close to this amount in the last 30 years in baseball.

Mr. KUCINICH. Now, how do you put that in the context of the fact that, according to reports and according to information this subcommittee has, that city officials will have a luxury box available to them?

Mr. HUMPHREYS. Well, this is part of the dirty little secret of the economics of these stadium deals. As part of the negotiation, if you are going to provide a brand new stadium with publicly subsidized money for a team, that is very common in these lease deals for the local officials to get access to a lot of free tickets. And if you look at the lease deals for both the new Yankees and Mets Stadiums, they are getting a lot of tickets and they are getting luxury boxes. These are not like, well, we have some bleacher tickets left over, we are going to give them to you so you can use them. It is a very valuable service that they are getting for free.

Mr. KUCINICH. I don't know if staff has this information, or maybe one of the people who testified does. Do city officials who have access to this luxury box, do they pay for these tickets at the market value of the tickets so that they just have access to it and they are paying for it, or are—Mr. Brodsky.

Mr. BRODSKY. The luxury suite is purchased with the proceeds of the bonds. The city officials, themselves, pay nothing.

Mr. KUCINICH. Are there any ethics laws in the State of New York with respect to what kind of a benefit somebody can——

Mr. BRODSKY. It depends on whose money it is. If that is city money, which the city says it isn't, then it is city money for the city officials. That is OK. If it is private money, which the city says it isn't, then the private money is buying a benefit for the city officials. It is extraordinarily complicated, and I think——

Mr. KUCINICH. Does the outcome of the IRS ruling have a bearing on this?

Mr. BRODSKY. No, because these bond proceeds are from the taxable bonds. It is a question of whose money it is. It goes to your question about whether PILOT is a tax payment or something else.

For the purpose of the exemption, it is a tax payment; for the purpose of these things, it isn't. So what this needs is a forensic accountant and somebody who wants to apply the law fairly to everybody.

I didn't get any pleasure out of this mess, but the fact of it is that when you examine the details of the economic and legal relationships they stink, and somebody has to start saying there is no public interest in this that can be measured or was measured by the people who made the decision. It was done in secret, and it was done in ways that benefited them and not the public at large.

Mr. KUCINICH. But along those lines, you know, we are both in politics. You sound like you have some connection that is close to your constituency. How do people respond to it when they understand that New York city officials will be able to go to games for free while the rest of the Yankees fans are going to pay—what's the percentage increase?

Mr. HUMPHREYS. It is 600 percent at the top, 139 or 140 percent on average.

Mr. KUCINICH. OK, from 140 percent to 600 percent increase. How do people relate to that?

Mr. BRODSKY. Well, the reactions I have seen, including in electronic media, is, Oh, there they go again. I have a great belief in the virtue and integrity of public service, but this kind of stuff kills it.

Mr. KUCINICH. Yes. OK, Professor Humphreys, I want to go back to this idea of the ticket prices. What do you say to the argument that if the market will bear higher ticket prices it is because the stadium-goers are benefiting from this enhanced experience and are willing to pay more money for that, and by definition the market is guaranteeing the optimum utility given the full stadium experience?

Mr. HUMPHREYS. Well, I would say that the market would guarantee that if there was competition. All these sort of nice properties of markets and prices efficiently or in a good economic sense allocating scarce resources like tickets to Yankees games, that all works if there is competition, and in particular if there is some viable substitute, some close substitute or some other producer that is able to sort of curb the tendency of monopolists to raise prices.

I mean, we certainly know from economic theory that monopolists raise prices. That is why utilities are regulated. And it is not outside of the purview of public economic policy to regulate prices charged by other monopolists.

Mr. KUCINICH. Right. I just have a final question here, and that is, given your expertise, can you explain how cities who build stadiums for teams typically deal with stadium naming rights? I have always been mystified at how cities can make a rather enormous investment of tax dollars, whether it is local, State, or Federal, into these facilities and then have somebody else come along and put their name on it. How do these cities who build these stadiums deal with naming rights, and, to the extent the teams are typically granted these rights, how much are these rights worth and why are cities willing to grant them to teams?

Mr. HUMPHREYS. Well, the details of naming rights are hashed out in the negotiation between the teams and the cities when they

are building the facilities. The teams always have the upper hand in that negotiation for reasons we have talked about through the course of this hearing. But you can always threaten to move. There is all sorts of reasons that teams have this power in negotiating. So they hash those things out, and it is, I think, a sort of low-cost concession that a city or local government can make to a team. OK, we will give you the naming rights, even though they are incredibly valuable. That is one of the reasons that it is often given to the team.

Now, it is not always given to the team. There are instances where cities have retained the right to name the stadium or have control over the name of the stadium, so I wouldn't say it is always given away, but it is basically because of the power the teams have in these negotiations that awards them that. And it is incredibly lucrative. It is tens or hundreds of millions of dollars for these naming rights deals.

The Atlantic Yards case in New York is a classic example. A bank paid almost $200 million for the naming rights of that facility.

Mr. BRODSKY. Congressman, you might want to look at the related activities of the Yankees and the city in selling off the salvage assets of the stadium.

Mr. KUCINICH. Selling off what?

Mr. BRODSKY. The salvage rights to the seats. I am told, for example, that the Yankees are now, instead of replacing bases on the first inning and fifth inning, are replacing them much more regularly and selling them as memorabilia at $800 a pop. Now, whose property that is is something the committee, my committee, is currently looking at. But you can go on to the selling channel on TV and buy yourself a foul pole and buy yourself some of the dirt from Yankee Stadium, and the bases, $800 a pop.

Mr. KUCINICH. Thank you. As this committee's work continues, the price of dirt at Yankee Stadium may go up. I want to advise the witnesses that this subcommittee is going to continue its work, that we expect at a hearing in the not-too-distant future to have invited guests from the city of New York Finance Department and from the New York Yankees. It may be in October, which has generally been a good month for the Yankees.

I want to thank you for your presence here. You have contributed greatly to helping to improve the understanding of these issues. I particularly want to thank Mr. Brodsky, because your report is something that members of this committee should have the opportunity to read in full, and I am certainly going to transmit your testimony, as well as the others individually, to the members of the committee so that they have a chance to review it, because these are serious national policy issues which the witnesses have raised.

We are grateful to you, Assemblyman Brodsky, Professor Gillette, Professor Humphreys, for testifying.

This has been a hearing of the Subcommittee on Domestic Policy of the Oversight and Government Reform Committee. The topic of today's hearing: "Gaming the Tax Code: Public Subsidies, Private Profits, and Big League Sports in New York."

I want to thank all the witnesses. This committee stands adjourned.

[Whereupon, at 11:50 a.m., the subcommittee was adjourned.]

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